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# UNITED STATES–JAPAN STRUCTURAL IMPEDIMENTS INITIATIVE (SII)

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## HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

NOVEMBER 6 AND 7, 1989

(Part 2 of 3)

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# UNITED STATES-JAPAN STRUCTURAL IMPEDIMENTS INITIATIVE (SII)

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MONDAY, NOVEMBER 6, 1989

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
*Washington, DC.*

The hearing was convened, pursuant to notice, at 2:05 p.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the subcommittee) presiding.

Also present: Senators Bentsen, Rockefeller, Packwood, Danforth, and Symms.

[The press release announcing the hearing follows:]

[Press Release No. H-50, October 5, 1989]

## FINANCE SUBCOMMITTEE ON TRADE TO HOLD HEARINGS ON STRUCTURAL IMPEDIMENTS INITIATIVE

WASHINGTON, DC—Senator Max Baucus (D., Montana), Chairman, announced Thursday the Subcommittee on International Trade will hold two hearings on the U.S.-Japan Structural Impediments Initiative (SII).

The hearings are scheduled for Monday and Tuesday, November 6th and 7th, 1989 at 2 p.m. each day in Room SD-215 of the Dirksen Senate Office Building.

The SII was launched on May 25, 1989 when the administration announced its plan to implement the Super 301 provision of the Trade Act. The SII is to be a set of bilateral talks with the Government of Japan aimed at addressing structural economic problems such as the Japanese distribution system and land policy—that hinder U.S. exports to Japan. The first round of discussions for the SII were held September 5th and 6th in Tokyo. The next round of discussions will be held on November 6th and 7th in the Finance Trade Subcommittee. The SII is scheduled to conclude in the summer of 1990 with a mid-term report due this spring.

"I applaud the Bush administration for launching the SII. I have for some time urged the administration to begin discussions with Japan to address these broader structural problems," Baucus said.

"As the President's Advisory Committee on Trade Policy and Negotiations (ACTPN) noted earlier this year these structural barriers may be blocking as much as $30 billion in U.S. exports annually. If we are ever to eliminate the bilateral deficit with Japan, these structural barriers must be eliminated or at least sharply reduced," said Baucus.

The purpose of these hearings will be to survey private sector views on the SII. A wide range of representatives from the business community, organized labor, and academy will testify.

"I believe these hearings will demonstrate a very wide consensus in support of the SII. In my view, SII is the most important trade negotiation that the U.S. has ever entered into," Baucus said. "If the SII does not succeed on schedule, I plan to push for legislation requiring the administration to initiate Section 301 investigations into some of the major Japanese structural barriers," said Baucus.

## OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator Baucus. The hearing will come to order. We are today holding a hearing on the Structural Impediments Initiative that the United States is conducting with the country of Japan. I think this subject is potentially the most important trade initiative this country will take this decade and perhaps into the next because it finally begins to fundamentally address the heart of the problem in our trade relation with Japan—namely the distribution system problems, other anti-competitive practices, bid rigging, for example, the keiretsus in Japan, the vertical integrations in Japan, as well as fundamentally addressing some of the problems in this country which tend to help prevent the trade deficit of being eventually eliminated.

We are very honored today to have with us an array of Americans to testify who have very direct experience. Also, we are particularly honored to have with us this afternoon the Chairman of the full Committee, who has been very, very actively involved in pursuing the remedies and finding remedies to the trade imbalance that our country has with Japan, as well as some other countries. And also, Senator Packwood, the ranking minority member of the full Committee who is equally involved in trying to find solutions to the trade problems we have.

At this point I would like to turn to my Chairman, the Chairman of the Committee, for any statements or questions that he want to put generally to the panelists.

## OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS

The Chairman. Thank you very much Mr. Chairman. I congratulate you on the meeting. I very much agree with the importance of it in the negotiations that we have ongoing with Japan.

But I would like to leave some questions for the panel. Unfortunately, I have some conflicting commitments this afternoon and will not be able to stay.

Ambassador Carla Hills has said that all we can expect from the SII talks is a substantial downpayment next year. I would like the business sector representatives who testify to tell us what they consider a satisfactory downpayment to be. In addition, I would like to know what we should be doing in order to monitor the fulfillment of those commitments.

Finally, we have a pretty sweeping reform agenda to propose to the Japanese—open up their distribution system, eliminate the cozy corporate relationships that keep out foreign investors, reform land use policies, and the like. But this is a negotiation, after all, and the Japanese have a pretty impressive list of structural reforms they want us to make to improve the bilateral trade balance, including balancing the Federal deficit and increasing the U.S. savings rate. Is it realistic to think we can deliver on any of the Japanese demands? Can we expect them to deliver on ours if we do not?

So those are some of the questions that I have. I'd like to see them answered without spending all afternoon at it.

Senator Baucus. Thank you, Mr. Chairman.

Senator Packwood.

## OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. Mr. Chairman, thank you. Like the Chairman, I have to leave.

But I have two specific questions I would like to address to Mr. Spero who is on the third panel. Mr. Spero is the President of Fusion Systems. If I might read the questions and then I would ask, Mr. Chairman, if he is not here if you would reread them for me when he testifies.

The first question is: Although I am not a patent lawyer, I understand that the United States has traditionally allowed multiple claims in a single patent application. Conversely, I am told that Japan, until recently, permitted only one claim per patent application. This difference could lead to a situation where a single U.S. multiple claim application containing ten patent claims could equal ten separate applications in Japan. Could you comment on this comparison problem.

The second question is: I would appreciate—and this is for Mr. Spero—I would appreciate your assistance in understanding whether the total number of patent applications can be meaningful evidence of patent flooding. I am told that in the United States there have been more than 1,000 applications filed on a seemingly simple product like automobile tires. Again, these could have contained multiple claims. Does this large number of U.S. applications on tires necessarily suggest that there is patent flooding in the United States as well?

Thank you, Mr. Chairman. If Mr. Spero is not here and did not hear those questions, could you ask them again and have him answer them for me in writing?

Senator BAUCUS. You bet. Absolutely.

Senator PACKWOOD. Thank you.

Senator BAUCUS. Thank you.

Now we get on to business. Let us begin with our first panel with Mr. William Archey, vice president of the Chamber of Commerce and also Mr. R.K.—Judge—Morris, director of international trade for the National Association of Manufacturers.

Mr. Archey, why don't you begin.

## STATEMENT OF WILLIAM T. ARCHEY, VICE PRESIDENT, INTERNATIONAL, U.S. CHAMBER OF COMMERCE, WASHINGTON, DC

Mr. ARCHEY. Thank you very much, Mr. Chairman. It's a pleasure to be here today on behalf of the U.S. Chamber of Commerce. I'm Bill Archey, international vice president of the U.S. Chamber.

The U.S. Chamber remains a strong supporter of the Omnibus Trade and Competitiveness Act of 1988 and of its aggressive implementation, including use of Section 301 procedures to obtain trade liberalization agreements with Japan and other countries.

As you probably know, Mr. Chairman, the Chamber was the only general purpose national trade association that formally submitted specific names of countries to the trade representatives office at the deadline requested and we did name Japan, along with Brazil, Korea and India.

One of the points though that I would like to make is that Chamber's board 4 years ago, to the great surprise of a lot of people in Washington and certainly in the country, came out in favor of mandatory retaliation in the case of the violation of trade agreements with the United States. We still have that policy and strongly believe in it.

As far as the structural impediments initiatives themselves go, we do have reservations about those talks. We have even some ambivalence about those talks. We are particularly concerned about the lack of specific milestones, criteria for success and a number of other things that we think are a little vague. However, we also note that it is currently, for the administration, the operative approach for seeking to resolve the structural disputes with Japan. We, therefore, believe it ought to be given a chance to succeed.

What do you mean by that? We are talking about next spring. We are talking about the same way that Ambassador Hills is talking about. In terms of this question, there are two points: What is the downpayment; and, what is the blueprint?

Certainly we would not disagree with a minimum what Mrs. Hills is talking about, which is the whole question of enforcement of the antitrust laws of Japan and some backing off or removal of the present distribution system problems as they pertain particularly to the relevant small business legislation.

However, to go beyond that at this point, I think it is very difficult for us in our Committee to judge. I think that we laid out a very large four pages of structural problems in our submission to Mrs. Hills on March 24. It is a serious question as to whether or not any of these are going to be attacked or resolved. Certainly they are not going to be by April 30 of this coming year.

But what I would like to note is a couple of points. There are several points. The first is that it has become pretty clear to the U.S. Chamber—and we are going to be talking about this very publicly, I believe, in January—that increasingly America's foreign policy security interest in international relations in the 1990's are going to be more and more defined in economic terms. It also strikes me that we are very unprepared to deal with that.

The second point, an assertive trade policy, in asserting the legitimate rights of American exporters does not a protectionist make and that always seems to get confused, that somehow or other asserting the legitimate rights of American business in foreign markets to have legitimate equal access to those markets that those companies have to us is not only not protectionist, it strikes me it's fairly much common sense.

But it has always been a difficult thing for the United States to have that assertive policy because one, we didn't have to for most of the post-World War II era. Great powers and great governments do not deal with that. I once had a State Department official say to me, "Bill, you have to understand the reason why trade and economics isn't a priority in the State Department is, is those trade issues are just not significant."

My argument is that in the 1990's what we now refer to, those "larger foreign policy interests" is being geopolitical strategic military concerns, than in the 1990's the "larger foreign policy interests" of the United States are going to be the trade and economic ones. I just do not think we are structurally ready to deal with that in our own turf.

The last point. What is increasingly occurring in the last few months seems to me, this incredible dichotomy or conflict in terms of the issue with Japan, that on the one side, even within the United States, if the United States would get its act together we wouldn't have to worry about all these things over in Japan.

The other side of the argument is, is if Japan would get its act together and we do not have to do anything, everything else would be fine as well.

My argument is that the notation that the United States has problems of its own and Japan also has problems are not mutually exclusive issues, that it has to be either one or the other. It has to be both. It has to be us making some efforts in a number of areas; it has to be the Japanese opening those markets.

My point is very simple. If Japan removes all of its present considerable barriers to imports, particularly American imports, and we do nothing on this side to improve what we do in the macroeconomic and in the business policy sides, we will make some incremental gain, but it is not nearly what it should be. If the United States does everything right in the macroeconomic sense, in the business policy sense, and Japan does nothing, we will see virtually no major in roads into the Japanese market because much of the Japanese market entry has nothing to do with market considerations.

That concludes the summary of my comments. Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Archey appears in the appendix.]

Senator **BAUCUS**. Thank you very much, Mr. Archey.

Mr. Morris.

## STATEMENT OF R.K. MORRIS, DIRECTOR, INTERNATIONAL TRADE, INTERNATIONAL ECONOMIC AFFAIRS DEPARTMENT, NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, DC

Mr. **MORRIS**. Thank you, Mr. Chairman. NAM shares your view, Mr. Chairman, that the current negotiations with Japan, the structural impediments initiatives, are extraordinarily important. We are grateful for the series of hearings you are holding and we appreciate this opportunity to participate.

At the outset of my testimony, I want to state clearly that NAM strongly supports the administration's May 25 decisions respecting Japan—both the Super 301 decisions and the decision to initiate the broader SII structure impediments negotiations.

In my prepared statement there is a discussion of the relationship between these actions vis-a-vis Japan and the overall trade policy of the United States. Here, I should like to concentrate solely on the Japan issues. We should not kid ourselves. Japan derives significant benefits from her trade surpluses with the United States and other developed countries and from the difficulties others encounter investing in Japan. We cannot expect help from the Japanese in reducing their surplus or our deficit unless we in the United States can demonstrate the very great importance we attach to constructive change in this area.

On May 11, Mr. Chairman, NAM offered its advice to Ambassador Hills on Japan and the Super 301 provisions of the 1988 Trade Act. We expressed concern that the unique opportunity presented by Super 301 might be diminished if all that resulted were sectoral negotiations associated with the naming of priority practices. The 1988 Act itself seems to express this same concern when it says, and I quote, "Our trade and economic relations with Japan are complex and cannot be effectively resolved through narrow sector by sector negotiations."

NAM suggested that, rather than focus on practices, the administration follow the advice of another section of the bill and that the President recommend to the Prime Minister of Japan an economic summit. In making this recommendation, we provided USTR with a list of NAM's concerns and expressed the hope that these would figure prominently in future negotiations. We also suggested that one or more of these concerns could serve as the basis of self-initiated 301 cases if USTR concluded that that action were warranted.

The structural impediments initiative announced on May 25 spoke directly to these concerns. At this stage we want to do what we can to make them a success. With that in mind, NAM has undertaken a survey to try to learn more about the views of manufacturers on United States-Japan economic relations.

Today I can share with you only some of the preliminary results of that survey. Later, we will provide the subcommittee with a final report. Of the approximately 50 companies who have responded so far, 90 percent have some business dealings with Japan, either as exporters, importers or investors. Overwhelmingly, they believe that Japan is less than half as open as the United States to both imports and investment.

As you know, Mr. Chairman, U.S. negotiators have identified six facets of the Japanese economy as structural impediments to improved economic relations. The preliminary results of the NAM's survey suggest that of these those which relate to the distribution of goods are the most important. Here I am including what some might call antitrust considerations. But these include ((1) the exclusionary business practices under which Japanese firms purchase their parts and supplies from long-term business partners; ((2) the closely related keiretsu system of relationships marked by cross holdings of stock which feature so prominently in the activities of Japanese companies; and ((3) the physical distribution of goods.

Mr. Chairman, I have just returned from a month long trip to Japan. Throughout my stay, I was consistently reminded of the importance of these impediments. A well-known business consultant in Japan, for example, told our group that the mentality of purchasing agents in Japanese companies is the single most important non-tariff barrier in Japan. He was referring to the practice of these executives of focusing almost exclusively on existing supplier relationships.

Separately, we toured several Japanese factories and were impressed, as one almost has to be, by the efficient use of labor. We saw a lot of robots and no extra hands on the factory floors. In the shops and on the streets, however, the inefficiencies of the distribution system were clearly evident. Japan's service sector, including its nearly 2 million retail outlets and 420,000 wholesalers, is a wash with hidden unemployment.

I should note that the survey form that we are using is not restricted to the six issues listed by the U.S. Government. We have also asked for comments on other facets of Japan that might be addressed under SII, as well as on the characteristics of the U.S. economy that the Japanese have identified as structural barriers here.

In aggregate, respondents to NAM's survey believe that U.S. investors in Japan have not been able to operate with the same freedom as Japanese investors in the United States. I am sure Mr. Pickens will have more to say about on that subject later on today.

Further, our respondents believe that, at least in some instances, the Japanese patent system has been used to deny the legitimate intellectual property rights of U.S. companies. It's my understand that an NAM member company, Fusion Systems, will speak to that issue.

Respondents to our survey also belief that administrative guidance in Japan has been used to distort the allocation of resources in a way that is detrimental to American interests. It is important to note, however, that manufacturers who have answered the survey agree that the Japanese have a point when they criticize American training and education, that there is merit in Japan's criticism on the emphasis of short-term strategies in the United States, and that the Japanese are clearly correct in citing the relatively low levels of U.S. export promotion as a factor undermining U.S. competitiveness.

In summary, Mr. Chairman, both Japan and the United States view their interaction with the outside world as a special source of strength. For us, that idea is captured in phrases like "melting pot" and "Nation of Immigrants." For Japan, it is expressed in the slogan, "foreign technology/Japanese values."

The difference between the two approaches is that we in the United States have assumed that everyone and everything can be assimilated and that America will always benefit from the changes. The Japanese, on the other hand, have struggled to borrow with surgical precision and to protect themselves from the ramifications of foreign influence.

Today, the two countries face challenges that are mirror images of one another. Japan must learn to borrow more than technology and selected systems. She needs to begin by giving markets a freer reign and her consumers a better deal. We, on the other hand, need to improve our ability to address foreign realities that cannot be changed. We need to make ourselves competitive even in an unfair world.

The SII offers both countries opportunities to meet these challenges and so lessen the growing tension between them. We will continue to work for its success.

Thank you.

[The prepared statement of Mr. Morris appears in the appendix.]

Senator BAUCUS. Thank you very much, Judge.

Mr. Archey, you mentioned that even if the United States does everything right—and by that I assume you mean savings rates, solve the budget deficit, significantly reduced if not eliminated, better attention to some of the educational systems in our country—that even if, in your judgment, the United States does everything right, that still there will not be a significant improvement in the reduction of the trade imbalance with Japan.

Mr. ARCHEY. I think there will be some, but it will not be nearly what it should be.

Senator BAUCUS. Could you expand on that, please? Why?

Mr. ARCHEY. Well, I think there will be some because there may be some areas that if, you know, all this of doing things right including increase in R&D, increase in capital investment, I mean things that the companies themselves have to do, that if everything was done right, there may be some companies in certain sectors that a Japanese customer may, in fact, go with an American vendor.

But what I am saying is, I do not think it is going to be great because the issue is that those judgments are not made on market considerations because it is not made on the basis of whether or not the American company may have the best product, the best quality—or at least of equal quality—better price, equal or better servicing, the issue is not all of those market considerations. The issue is, either you have been a long-term supplier, you are a part of the family, you are a part of the keiretsu, and all those kinds of things. The judgments are not made on the way American business makes them, which is on the basis of the commercial considerations.

Senator BAUCUS. Judge Morris, do you agree with that?

Mr. MORRIS. I think that that is the essence of the problem. Yes, I would not disagree with that. But I believe that the structural impediments initiative does—there are other components and that it offers some hope.

In the first place, we are seeing with the cross investment, you get access to the problems in Japan through the U.S. system, that's the antitrust angle. Separately, to the extent that you can do things on certain issues—whether it be the land values, whether it be the large scale store law—everything you can do helps a little bit. But the real nut that one has to crack is the interrelationship between Japanese companies that are characterized by the term "keiretsu."

Senator BAUCUS. I would like each of you to tell us what, as a minimum, you would like to see as a result of these talks. That is, if there is some talk about blueprint, downpayment, et cetera, from your point of view, what is the minimum that we should look at in determining whether or not the talks have been successful. I mention that because I am now drafting a bill which I will introduce depending upon whether or not the talks are successful. The bill basically provides that if the talks are lagging, if they are unsuccessful, if they are unproductive, then the administration must use Section 301 as a remedy to try to address at least the trade aspects of the structural impediments that we are now addressing.

I will introduce that bill if it looks like it is dragging. But I would like, from your point of view, to know, what the minimum standard would be in determining whether or not these talks are successful.

Mr. **Morris**. It seems to me that you can break the analysis into two, but in doing so you have to look at the Japan relationship as a whole. In other words, you have to look at the Super 301 actions that are happening as well as the structural impediments initiative.

In the Super 301 case you have the clear ability of the Japanese Government to change their practices, without in a sense changing the whole society. That would be the place I think one would look for a good faith effort on the part of Japan to open up.

With respect to the larger issues, things like the keiretsu system, things like the land values problem, the question is: Is what Japan has put forward credible? For example, they can initiate tax laws which will have beneficial effects on land values, they can encourage movement out of Tokyo. There are lots of things that can be done. But you are not going to see overnight shifts there.

So I don't think you can set up a definite answer in terms of the big issues of what the test is. The test is whether or not it is a genuine, good faith effort. I think that the experts at USTR can evaluate that.

Senator **Baucus**. Mr. Archey.

Mr. **Archey**. Judge and I agree almost on everything, quite frankly, in this area and I have an enormous respect for his judgment. But what constitutes a good faith effort is a little bit illusive and has been for the last 15 years of trade negotiations with Japan. On the other hand, it is a little bit like pornography. You know when it is a good faith effort, but it is difficult to define it.

I think the reason for our concern is that it is the larger issues that we are really going after. Mrs. Hills is fond of talking about the fact that when they were over in Japan and Jules Katz was over there they were talking with the companies about super computers and some people—I do not know if they were government or not—talking about the fact of, we will buy three super computers; and the argument being that that is not the issue. The issue is that if you buy three super computers but your market is still essentially closed it is just merely another illusion and elusiveness on the part of the Japanese. So the argument was, well then we will buy five.

The point that I think has to be made is, is no. Let's make the market open. Obviously what we are saying—one thing we do agree with with Mrs. Hills is that at a minimum, why don't you begin to enforce the antitrust laws of Japan which gets to some of the problems that Judge has talked about in terms of one aspect of how to reinforce the keiretsu system. I think that that is a minimum.

The second point I think is, that we would like to see this blueprint that USTR talks about and I would like to be able to make that judgment when it is in front of me. We are putting together a group now of things that we would like to see. But I must confess to you, at this point in time it is too early for us to make that judgment.

Senator **Baucus**. What about some numerical targets? I mean, surely—I understand, you want the distribution system if not dismantled, at least open; antitrust laws enforced. How do you know this coming March whether or not the blueprint will in fact result in dismantlement of distribution systems, at least abolition of the most obstructive practices involved?

Mr. ARCHEY. Well, I think Judge talked about there are a number of laws that they could go about immediately making some changes in. That would be the most concrete example, where the changes were, in fact, effected. But number two is, again, as we see with a number of countries we engage in trade negotiations with, they will make those tangible changes.

We have seen this to some example in Korea. Laws are changed, but it is very clearly intended not to implement that law terrible effectively. So it cannot be just the changing of the law.

Senator BAUCUS. Well, that is the question I am getting at. So they change the law, how do we know if it will be implemented?

Mr. ARCHEY. Well, I think that is the point that goes down to this notion of the blueprint that has the kind of specific milestones—I mean dates for when certain actions will take place that we would like to look at. I don't—the problem with the question that I think you are posing, Mr. Chairman, and Chairman Bentsen is proposing, is that it is a valid question. I think it is a little early to finally answer that question. But I think come this spring, the U.S. Chamber, if it feels that what is coming out of the structural impediments initiatives is not very forthcoming and it is basically, you know, the Yogi Bear deja vu all over again, we are going to recommend very strongly the use of Super 301, even though everybody says that ought to be the last resort.

Perhaps that should be. But I happen to think that after the years of these negotiations that have not begotten substantial market access of equality of opportunity to penetrate those markets, that maybe something like that has to happen.

Senator BAUCUS. Thank you.

Senator Danforth.

Do you want to respond?

Mr. MORRIS. Yes, Senator, thank you very much. There is something I wanted to say to that.

Super 301 is a very valuable tool. But I think it is important not to overrate it in this sense. One, it is already possible for the administration to initiate a 301 on anything. That's one point. And the second point is, there are outs for the administration, even on Super 301. In other words, you could go through the process and not have a retaliation, even if you were not satisfied with the result.

From our point of view, that would be a disaster. What I am saying is, that it does not make sense for the United States from the point of view of manufacturers to have its rhetoric louder than it is prepared to carry through. So I think we are a little bit concerned that we not get ahead of ourselves and that we understand what the objective is to be achieved and what the government—administration and Congress, together—are prepared to do in the event that you do not achieve that objective.

In so far as milestones are concerned, I think we all know that the real milestone is the deficit. If we do not get some reduction in our immovable $50 billion deficit with Japan, then some further action is going to be necessary.

Senator BAUCUS. Thank you.

Senator Danforth.

Senator DANFORTH. Thank you, Mr. Chairman.

Well, I guess the question is, and both of you have been discussing it, how do we deal with large scale problems in measurable form? That is really the issue that Mrs. Hills raised. She wants a blueprint. She wants something that is concrete. That is also the issue that Senator Baucus has raised with his suggestion that the structural impediments talks be brought under Super 301.

I do not know the answer to that question, and I would welcome anything more that either of you have to offer. I thought last May that it was a good idea, together with the Super 301 designation of Japan, to enter into these discussions. I do continue to think it is a good idea. I guess the problem is: If you make it too concrete, if you have too many benchmarks, too many targets, then it is no longer a broad discussion. If you say to Japan, buy three super computers, they will do that and think they've taken care of the problem.

So how can we be at once broad enough in our complaints to avoid being thrown a few bones but also concrete enough to get some meaningful solutions for these problems?

Mr. ARCHEY. I think the complaints, certainly the ones that we delineated in our submission in March, they are general only in the sense of categories, but quite specific as to within those categories—distribution, restrictive practices, administrative guidance to companies, all of those things. We lay out in a fair amount of detail about how it plays out. I think in those you can come to some quantitative measurement that I think is enhancing of the situation.

I would suggest, though, Senator, that one of the problems I think we are going to head into—and it always happen, particularly with Japan, although I think it is going to start happening with Europe as well—when the United States plays tough, and in my sense not protectionist, but tough, in asserting its rights, the debate somehow or other in the front of the Washington Post or the New York Times are up in the halls of Congress and in the Executive Branch becomes a debate between protectionism and free trade.

It is about time we dropped those as being the essential parameters of the debate because they are both irrelevant. And yet, I can guarantee that when we get down to the closing point next spring the papers are going to be filled with "Senator Boom" who thinks that we ought to be tougher is a protectionist.

Senator DANFORTH. Yes. And if you will excuse me, furthermore, he will be tagged for engaging in Japan-bashing.

Mr. ARCHEY. Yes.

Senator DANFORTH. That is the label that is automatically and, I think, mindlessly stuck on anybody who does anything other than heap praise on Japan for what it is doing. If you raise the question, if you do anything other than blame America first for all of our bilateral problems, then you are automatically labeled a "Japan basher." So I think you are absolutely right.

Mr. ARCHEY. I see nothing that is going to change in terms of this.

Senator **Danforth**. It has nothing to do with free trade or protectionism.

Mr. **Archey**. Right.

Mr. **Morris**. Could I make a—in the first place, I would agree profoundly with Mr. Archey's comment that free trade and protectionism are both somewhat irrelevant terms and it is regrettable that the debate is characterized by them.

With respect to your beginning question, Senator Danforth, the very large issues that are addressed in SII, one of the problems with putting them under something like Super 301 is that when you get in—if you were to measure retaliation, you would get into such large numbers and it would be ridiculous and any threat would not be credible. That is why I think one has to look for the areas like super computers where threats are credible for the measurable differences.

But I also think that whether it is in terms of anecdotal data, the kinds of experience, however Mr. Pickens exercise turns out in terms of the openness of Japanese society to investment in the way that we know it, these things can be judged and there is much greater chance of progress if we keep pushing on those things. Because there are forces in Japan—if it is in the retail area—there are people who would like to operate those larger stores that will benefit and work with us and you will see progress. But it is not the kind of thing that is susceptible to a Super 301 action.

Senator **Danforth**. Can I ask you, you said that it is too early to judge the SII because it is just getting under way. But how about Super 301, is it too early to judge Super 301? Is the jury still out on that or is this basically a good provision or a bad provision?

Mr. **Morris**. Oh, you mean the fact that it existed. I think that it is a very good program, personally. I believe though, and I believe that Ambassador Hills has characterized it properly to trading partners who have yet to hear her. I have never heard anyone acknowledge her testimony here and elsewhere that this is a setting of American priorities. They always look at it as un-GATT retaliation which has not occurred.

But the fact is that that provision did force a setting of priorities which was desperately needed and in that sense it was a very, very helpful tool.

Mr. **Archey**. I guess I would agree that it has been useful. I think it is a little early. But I give you one quick anecdote, Senator, because I think it captures a lot today as well. I was at a dinner about 2 months ago, 3 months ago actually, for a prominent foreign trade minister from Europe. I was sitting next to his executive assistant at the dinner. I threw out my argument that the Europeans were awfully hypocritical about the American trade bill when it came to Super 301 because this was unilateralism when the entire underlying motive of 1992 is filled with the issue of reciprocity that is far more ambitious, far more hard hitting in terms of both outcome and magnitude than is Super 301 which is an attempt to open up other markets by leveraging access to ours.

And interestingly he agreed, that indeed the Europeans are being hypocritical. But he then said to me, he says, "But let me explain why." He said, when you Americans want to assert your trade rights you get together a large number of lawyers and legislators in a very public way and you bring them all together in a very complicated way which opens you up to second guessing, and you bring out these big 16-inch guns through legislation. It is therefore by definition subject to all kinds of second guessing. And then, even when you go and do that and you use it, we wait about 3 to 4 months for you to start feeling guilty about having done it.

He said, invariably, that is what happens. Whereas, in our country, if we want to assert our trade rights we just do it. I am wondering sometimes if we couldn't get a little simpler about our approach to this because sometimes one of the arguments made about Super 301 is—and we still are a strong supporter of it—that it raises the public face-saving aspect so high that it forces countries into a position where they may not want to cooperate.

I think it is still a little too early. We will see in the next round.

Senator DANFORTH. Thank you.

Senator BAUCUS. I have a couple of questions for both of you. Mr. Morris, you mentioned that ultimately it is the reduction of the trade deficit that determines how successful we are. How much must the trade deficit be reduced, or how much do you think it will be reduced if the SII talks are in fact successful?

Mr. MORRIS. I would hesitate to project a deficit reduction now. Basically we only see a slight fall off in 1989, as opposed to 1988. That is what we are upset about. I would comment that part of the rationale for SII was that you were going after issues which could not be resolved in a year. I think that that is true. That does not mean that you do not have to make progress.

So that, while I believe it is the case that both for manufacturers and in political terms, the real test in the end is going to be the trade deficit, I am not prepared to say. I do not know. It would false to say when we are going to see a big jump downward in that. I am hoping within the next couple of years you will see it reduced.

There are trends, some of them not entirely encouraging like Honda exports to Japan, which work in that direction. I am afraid I cannot answer it. I do not know when we are going to see the reduction, but I know we must see it. I know the Japanese know that we must see it.

Senator BAUCUS. But you must have analyzed this to some degree. Let's assume that talks are successful again. You know, Ambassador Hills comes before the Congress, talks to you and mentions what she has done. It is a good blueprint and it looks like Japan is in fact passing the laws and enforcing the laws which will result in a much more competitive Japan. How much will the deficit come down in your judgment?

Mr. Archey, do you have a view on that? What are we talking about—10 percent, 50 percent, what?

Mr. ARCHEY. I am not sure that I want to get specific either. I will give you one, perhaps, guidepost. If U.S. companies started getting the percentage of market share in Japan that they have in other developed countries in the world, like semiconductors—what is it, 43 or 44 percent in Europe; 7 or 8 or 9 percent in Japan? Super computers, 75 percent in the rest of the world; and it is what, 10 to 15 percent at the most in Japan? The chemical industry—a very large, very successful U.S. companies in Europe and in other developed countries—a minuscule percentage of the market there. Pharmaceuticals.

What I am saying is that one—as you know in the dumping countervailing duty area, sometimes when you have a nonmarket economy you have to use a third country construct of what would it be like if you were doing business with a third country that was market-oriented.

I think we are going to have to start coming up with those kinds of criteria that says, you know, what is a fair way to compare this in terms of other countries of the world. The estimates are—a Bob Lawrence study at Brookings that has been reinforced by a number of other studies, that notes that the Japanese for the size of their economy, per capita income, et cetera, under imports by somewhere between $30 and $50 billion.

So we are not talking about small numbers when we talk about a system that is truly open.

Senator BAUCUS. But should we use figures like that—$30 billion—$40 billion—$25 billion?

Mr. ARCHEY. No. Because one of the things I think we have also learned, Senator, is that—and I think we have learned it in some instances the hard way, and other ways I think we ought to be proud of it—the United States, which we do not get enough credit for, Super 301 trade bill and a lot of other things, we have opened a hell of a lot of markets up in this world and we have not always been the beneficiary of same.

But all this stuff of unilateralism about the United States, it is interesting when we do certain things with Taiwan, Korea, et cetera, how many other countries have benefited from our efforts in having done that.

Senator BAUCUS. How easily can Japan act? What I am getting at is this: It seems to me that land values in Japan are very much overinflated. I saw the figure that the total market value of real estate in Japan now is four times the total market value of American real estate, which is incredible. The area of Japan is the same as the area of my State of Montana. It is just one of 50 States. If the market value of Japanese land now is four times the market value of real estate in the United States, then that is an ominous statistic.

If that is the case, and if, say, Japanese stocks are overinflated—most observers think that they are—and if there is this very intricately related, you know, keiretsus and mutually inclusive business arrangements in Japan as there seems to be, all of which tend to be anticompetitive, tend to prevent the true market value from being determined, add on top of that the sales of Japanese companies to their consumers, up to a 30, 40 percent higher retail sales price compared to the sales price for the same good in the United States—if you add all that together, that's just massive.

How easily can Japan dismantle all of that? We know it happened here in the United States facing the S&L industry when land values were dramatically reduced. What is going to happen in Japan? That is not to say all this is valid in Japan; it is all invalid in my judgment. But how easily can Japan make these changes and how can we help them make these changes? I wonder what thoughts you have as to how easily they can do all this.

Mr. ARCHEY. One, I do not think it is going to be very easy. Number two is, though, the issue has not been tested because there has never been enough pressure put on by the rest of the world to focus on these kinds of issues so as to even think that one could progress toward them.

I think it has been a very unfair rap on this so-called revisionist school that—Van Wolferen, Prestowitz, Fallows, Chalmers, Johnson and others, that somehow or other when you call them the revisionists it is almost by definition pejorative. I think what they have done is cut through an awful lot of the theology of Japan and got it down into some issues that could be intellectually understood in terms of how the system works or does not work.

And now that that has been defined, I think that the kind of pressure that can be put on, where the buttons are, that have to be pushed, because I will say I have been following this trade stuff, as you have, Senator, for a long time. In the last 10 years one of the things that has been very difficult is to pinpoint, what are some of those things, those so-called structural systemic things. In the last year and a half, 2 years, there has been a major advancement in the diagnosis and definition of those.

I think now we can begin to put the kind of pressure on the kinds of things that do not comport with the way the rest of the world conducts trade.

Senator BAUCUS. I very much agree with you. In the years I have followed this, my thinking has changed too. The names of the economists and the observers that you mentioned are accurate in breaking through some of the mythology that evolves around Japan and this issue. I think too, as you said, and as Senator Danforth said very eloquently, that this is not a free trade protection. It is an issue et al. We are trying to find ways to open up markets. We are trying to find ways to identify the buttons and to push them so that both countries, in fact, are supporting the economic well being of all the people in their country, not just an elite few and in one country in particular.

I think we have come a long way. And I think this structural impediments initiative is finally beginning to hit the bull's eye in trying to address some of these problems. I appreciate very much your testimony.

Judge, do you have anything else to add to this while we have the chance?

Mr. MORRIS. Thank you, Senator. Yes, I would like to say two things.

One, with respect to a remark that Senator Danforth made about anyone who is not praising Japan being cited as a "Japan basher." I, personally, think that is a serious problem, but it is one of the reasons you have to keep hammering and let it be shown that progress can be made in areas where you do have allies in Japan as in the land issue, in Retail Law One. Unfortunately, in the area such as the keiretsu system, it is harder to find allies, but it is a more important issue. There, we have to work not only on the government of Japan and the business people that we deal with, but I also am convinced from my brief exposure in Japan just last month that we have a heck of a P.R. job here.

That is to say, one gets hit with charges of inadequate quality, nothing to buy. A lot of this is simply not true, but the case is not made well enough and we need to begin to address it seriously. That means we have to redefine America as a strong exporting country, whether it be through stronger export finance, the whole litany of issues that I know you know well. But I think we, in the end, also have to look at the other side of the structural side of the impediments as well as the Japan side.

Senator BAUCUS. Good. Thank you both very much. We appreciate it.

Mr. ARCHEY. Thank you.

Senator BAUCUS. Okay, the next panel. Mr. Mitchell Kertzman, President and C.E.O. of Computer Solutions and Chairman of the Board of American Electronics Association; Mr. T. Boone Pickens, Chairman and General Partner of Mesa Limited; and Mr. David Leland, President of PlumCreek Timber Co., also a member of the Steering Committee for the Alliance for Wood Products Exports and also National Forest Products Association.

Before I begin, Senator Boren has some written questions that he is going to submit to the witnesses and I know you will answer them. He is an active member of this Committee. He is unable to be here at this time.

Senator BAUCUS. Okay. Mr. Kertzman, why don't you begin.

## STATEMENT OF MITCHELL E. KERTZMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, COMPUTER SOLUTIONS, INC., AND CHAIRMAN OF THE BOARD, AMERICAN ELECTRONICS ASSOCIATION, BURLINGTON, MA

Mr. KERTZMAN. Thank you, Senator. It is good to see you again. My name is Mitchell Kertzman. I am the chairman of the American Electronics Association and the C.E.O. and president of a company in Massachusetts called Computer Solutions. We are a $17 million software company that develops manufacturing software. It is a pleasure to see that only in America can all the press turn out to see a small company guy like me and I can pass the benefit on to Mr. Pickens.

The American Electronics Association applauds the interest of the subcommittee in the Structural Impediments Initiative and we believe that the imbalance in commercial relations between the United States and Japan will destroy the international trading system unless it is effectively addressed. The SII talks are an excellent approach to resolving the real problems between us.

The American Electronics Association is the largest association representing the U.S. electronics industry. Our 3,500 member companies include all segments of the industry from telecommunications, computer and instrument producers to semiconductor equipment and material suppliers.

American Electronics exports to Japan are only $6.3 billion per year compared to $26.8 billion of U.S. electronics imports from Japan. Our trade imbalance in electronics with Japan has been increasing slightly in recent years despite the substantial depreciation of the dollar vis-a-vis the yen and in spite of numerous United

States-Japan agreements in the electronics sector. We also forecast continued deterioration in these trends.

While our industry is generally healthy today we are deeply concerned with our longer term trends. Our global market share in many segments in shrinking rapidly. For example, in radio and radar we dropped from 68.8 percent in 1984 to 59 percent today; and instruments from 56.7 to 43.9 percent; and trends in medical equipment, components, data processing, semiconductors and some telecommunications are similar. Most of this market share loss has been to Japan.

The key problem facing U.S. companies in Japan is a strong buying national, cultural tradition which extends to Japanese government procurements. Even American companies that are successful in the Japanese private sector have serious problems penetrating the Japanese public sector. Firms in the same industry also exhibit strong collusive behavior which is not addressed by the government of Japan.

We concur with the administration's decision not to treat structural adjustments as an unfair trade practice under the Super 301 umbrella. While Japan's system should not be regarded in this context as an unfair trade barrier it is clearly doing damage to U.S. industry and to their attempts to penetrate the Japanese market.

These talks should also seek to address the impact of structural adjustment on bilateral investments. We believe that unless these structural problems are addressed in a comprehensive fashion, the future health of our industry is threatened as is the very survival of the gashed trading system. It is extremely important that we work with Japan to address all of these issues.

Among the categories identified for discussion under SII, the key impediments facing American electronics firms in particular, trying to sell in the Japanese market, fall into the category of exclusionary business practices. This category includes government procurement, intellectual property protection, toleration of anticompetitive practices and binational attitudes.

Another key problem facing American companies in Japan is a business structure where Japanese firms in the same keiretsu have preferential purchasing agreements with one another. An example of the result of Japan's government programs and private anticompetitive behavior is our semiconductor industry. The foreign share of Japan's semiconductor market has consistently remained at 10 percent, despite changes in the exchange rate and greatly intensified efforts by U.S. manufacturers to penetrate the Japanese market.

One reason is that huge vertically integrated firms that both produce and consume semiconductors represent a large portion of the semiconductor market in Japan. A very significant obstacle to U.S. sales in the Japanese market has been an inability to penetrate the Government procurement market in Japan, even in the NITI market where we have a trade agreement, our share is only 3.5 percent.

Although foreign computer manufacturers have been quite successful in their penetration of the Japanese private sector, they have had only negligible sales in the public sector. Foreign computer manufacturers' share of the Japanese public sector is 5.8 percent as opposed to a 36.4 percent share in the commercial sector.

Now it is very important that we recognize that many of the structural adjustment problems are our own responsibility. Frankly, it is our hope that our colleagues in Japan will press the U.S. Government in these talks to deal with our own economic problems that impacted this bilateral trading relationship. High among these problems from our point of view is the high cost of capital driven by our enormous budget deficit and our tax system which favors consumption over savings and investments.

Our Association has established a Japan task force, through which we will work with the U.S. Government and our Japanese colleagues to negotiate solutions to the bilateral problems that face both countries. We hope that our effort will support the government's structural adjustment talks. In addition to addressing these problems, we believe it is critical that the SII talks address some of our own problems that limit our competitiveness and our ability to export.

Thank you, Senator.

[The prepared statement of Mr. Kertzman appears in the appendix.]

Senator BAUCUS. Thank you, Mr. Kertzman.

Mr. Pickens.

## STATEMENT OF T. BOONE PICKENS, JR., CHAIRMAN, BOONE CO., AND GENERAL PARTNER, MESA LIMITED PARTNERSHIP, DALLAS, TX

Mr. PICKENS. Mr. Chairman and members of the committee, my name is Boone Pickens and I appreciate your invitation to testify here today.

In response to Trade Representative Hill's statement about downpayment, I really feel like we deserve more than a downpayment. I guess very simply stated, if the deal is haywire, let's fix it; but downpayment is overdue.

As you may already know, Boone Co. has a significant investment in Koito Manufacturing Co., a Japanese automotive lighting company. Now I believe our treatment, thus far, by corporate Japan, which contrasts sharply with the treatment accorded Japanese investors in the United States, is symbolic of the current trade relationship between our country and Japan.

Boone Co.'s position is truly unique because as foreigners we have acquired such a large position in the Japanese company. And since our initial purchase of approximately 20 percent of that company in March of this year, we have now increased our holdings to 26 percent. Despite our position as Koito's largest shareholder, our requests for financial and operating information about the company have been met with responses inappropriate for any shareholder, let alone a major shareholder. Moreover, our attempts to obtain representation on the Board of Directors of Koito have been rejected.

On the other hand, the next largest shareholder, Toyota Motor Co., with 19 percent ownership, holds at least three seats on the Board. At issue is what I call silent trade barriers that prevent

Americans from entering Japan's markets while the Japanese are free to invest in the United States. The Japanese, like other foreign investors, face no real barriers of entry to the United States' capital markets.

Sony Corp., for instance, purchased CBS records in 1987 for $2 billion and Columbia Pictures Entertainment, Inc. this year for $3.4 billion. Bridgestone Corp. of Japan bought Firestone Tire and Rubber Co. for $2.65 billion in 1988. Just last week, Mitsubishi Estate Co. agreed to pay $846 million for a 51 percent interest in the Rockefeller Group, Inc., which owns Rockefeller Center and other buildings in mid-town Manhattan.

Nippon Life Insurance and Dai-ichi Mutual Life Insurance, both shareholders of Koito, are two of the Japanese financial conglomerates using huge cash surpluses to increase holdings of American real estate.

Now this is only the latest of many Japanese purchases from Hawaii to Los Angeles to New York, and these Japanese companies are not limited to a minority stake in U.S. corporations. Many purchase 100 percent of the shares of the company and take complete control. Because of interlocking ownership in Japan, an American taking complete control of a Japanese concern would be virtually impossible.

A lot of people have asked me to be specific when I talk about structural impediments and there are many, but a prime example is our Koito investment. The one Japanese law designed to put some limits on interlocking ownership has been watered down in the last few years. Until 1982 no more than 70 percent of the outstanding shares of all publicly traded Japanese countries could be held by 10 percent or fewer shareholders. That standard has been exceeded by Koito, but the limit was temporarily changed to 80 percent; and this is a structural impediment.

After almost a year of analyzing all the facts, I have come to the conclusion that Koito managers still resist my investment because I represent a foreign threat their stable, closed cartel-like system. They cannot afford to let any Americans on the inside for fear of what we might discover. I have twice written Koito's large shareholders and I have not yet received one response. I also have communicated with Koito's small shareholders, and I have received replies from over 200 of those stockholders who hold more than 1 million shares of stock.

I brought along those replies which I will file with the Committee. But you can see, it is substantial from the small shareholders. Not one—not one response from the large shareholders.

[The responses appear in the appendix.]

Mr. PICKENS. Of those who expressed an opinion, 88 percent have been supportive of my efforts. One shareholder stated, "I will support your fight entirely. I ask you to cast away the managers who neglect the rights of shareholders."

Mr. Chairman, the problem is not limited to the closed system maintained by Japan. I urge you to examine the extent to which the Japanese are exporting goods and services. The Japanese exported to the United States roughly $88 billion of goods and services from July 1, 1988 to June 30, 1989. The automotive and electronics industry provided a good example of my point. Of that $88 billion, three major shareholders of Koito—Toyota, Nissan and Matsushita—account for 18 percent or $16 billion of the total. Those three are among the companies that contribute significantly to the huge trade deficit that this country faces with Japan.

Mr. Chairman, Japan's closed system is keeping out American competition and my great fear is that Japanese are also exporting their system of cartels into the United States in contrivance of our antitrust laws.

If Toyota's financial position is enhanced through the all powerful relationships with the Koito's of Japan, what is Toyota, Honda or Nissan doing with its same Japanese-owned suppliers who have followed their plants to the United States?

I am also convinced that the Japanese will use their U.S. operations as a platform for future entry into the European markets. With that, they will export from the United States, from Japanese plants, and it will be identified as American made.

For the past 100 years the United States has been free of trusts and cartels and we cannot permit the Japanese to sneak theirs through the back door. Busting Japan's trusts is essentially free trade. But with more and more Japanese investment in the United States, it is critical to the preservation of our own free enterprise system of open competition.

In closing, I urge your support of two legislative initiatives that I believe address the problem at hand. First, Senator Baucus, I endorse your legislation that would grant a cause of action under Section 301 in the event of a failure of negotiations under the Structural Impediments Initiative. And secondly, Representative Don Sundquist recently introduced a House resolution which encourages a reduction of barriers to Americans trading with or investing in Japanese companies. I have learned that the Japanese listen closely to members of the United States Congress. Therefore, I think a similar resolution in the Senate could have a positive impact.

In closing, I think it is time to take the gloves off these people and trade—trade hard with them; come up with some barriers that we can send our trade representatives to the table with.

I thank you for the opportunity to express my views.

[The prepared statement of Mr. Pickens appears in the appendix.]

Senator **Baucus**. Thank you very much, Mr. Pickens.

Mr. Leland.

## STATEMENT OF DAVID D. LELAND, PRESIDENT, PLUMCREEK TIMBER CO., AND MEMBER, STEERING COMMITTEE, ALLIANCE FOR WOOD PRODUCTS EXPORT, NATIONAL FOREST PRODUCTS ASSOCIATION, SEATTLE, WA, ACCOMPANIED BY JOHN RAGOSTA, OF DEWEY, BALLANTINE

Mr. **Leland**. Thank you, Mr. Chairman, for the opportunity to testify. My name is Dave Leland and I am President of PlumCreek Timber Co. I am also a representative of the Steering Committee for the Alliance for Wood Products Exports.

As such, I would like to start off by saying that we support both the Super 301 effort and the Structural Impediments Initiative. We think they both have a place and ought to move forward aggressively.

Let me just tell you a little bit about PlumCreek. It's a small, publicly held forest products company, with about $350 million in revenues. We grow timber and sell logs in both the export and the domestic market, as well as manufacture lumber, plywood and other forest products. About 3 years ago we aggressively started to export finished products (lumber and M.D.F.) from our mills in Montana to Japan and other parts of the world. Today we export about $23 million worth of forest products, about $16 of which is to Japan, our single largest export market.

I would like to enter into the record the written testimony that I have already submitted and would like to just make a few general comments about some of the things we and other members of the industry have experienced in our effort to export to Japan as indications of why both of these efforts—Super 301 and the Structural Impediments Initiative—should move forward.

There seems to me three important impediments that we have found in our business. One is the misclassification of tariffs. The second is tariff escalations. The third thing has to do with standards, and in particular, certification of products made here in the United States for use in Japan.

There is a product commonly used in Japan called a laminated post that is a glue laminated structural member used in traditional Japanese homes. The tariff classification as identified by the Japanese Government recently has resulted in a tariff of 20 percent. Under the tariff codes we believe it should be at 3.9 percent. A tariff of 20 percent makes the manufacture of those posts here in the United States uneconomic. The misclassification of the item in the tariff code takes U.S. manufactures out of the market.

The lumber that goes into those posts comes from the United States and sells for about $500 here. At their current 8 percent tariff that represents about a $40 tariff.

If the value is added here by laminating that lumber to make the structural post, that post would sell here for about $1,000, but carry with it a 15 percent duty. That duty is $150. The duty on the value-added portion, the difference between the raw lumber and the post of $500 then comes out to be 22 percent, far more than is necessary to protect the industry in Japan. That is an example of a misclassification of tariffs as well as demonstrating the impact of tariff escalation which results in overprotection of the Japanese industry. These are issues that I think should be properly taken care of under Super 301.

One of the other issues is certification of products for use in Japan. The Japanese Agriculture Service, JAS, requires certification of wood products brought into Japan. Currently, if a producer in the United States delivers forest products to Japan, particularly lumber, the lumber must be reinspected in Japan at a cost ranging from about 5 to 10 percent of the laid in cost of the product. In addition the additional inspection results in a delay in delivery time and reduces the dependability of the U.S. supplier. That makes that U.S. supplier undependable and often viewed by the Japanese purchaser as less desirable source of product.

We would think that it would be better to allow those certifications to be done here in the United States. Such authorization can be achieved, but it takes a great deal of time to get authority from the Japanese to do certification here in the United States.

Under the talks that took forth in 1984, 1985 foreign testing organizations are allowed here in the United States under the authorization of the Japanese Agricultural Service. As of yet, it is my understanding that only one has been certified in order to obtain such authorization the Americation Testing Agency had to agree to unnecessary and costly procedures not required anywhere else in the world.

So I think that is an area that can be improved and should be worked on through the Structural Impediments Initiative. With that, I would like to conclude my comments.

[The prepared statement of Mr. Leland appears in the appendix.]

Senator BAUCUS. Thank you all. I'd just like to ask each of you three questions. Number one: What is your minimum standard by which you will know whether or not these talks are successful? Second: By what date? And third: If the talks are unsuccessful by the standards that you have given, what alternative action do you recommend we take?

Mr. KERTZMAN. Well, from the point of view of the American Electronics Industry, I think as you have heard before those are difficult questions to answer. I believe that given our market share in the rest of the world and our market share here that it is not unreasonable to think that the doubling of our market share in Japan across the electronics sector is a reasonable goal.

Senator BAUCUS. Right now it is 10 percent in semiconductors.

Mr. KERTZMAN. Well, let me tell you what I—we just had some talks that I chaired with the EIAJ and I recommended the following: That we should look not just at the goal that we are setting, but the Japanese are very good at understanding total quality management. One of the processes of that is that you set a long-term goal and you measure continuous improvement to that goal. I think it is important not just that we set a specific target and a time for that target, but that we set a specific target and set a lot of very short-term increments by which what we want to see is not a specific number but improvement from the previous measurement. Every single measurement should represent an improvement.

I would like to see that kind of measurement.

Senator BAUCUS. If that is not there, and that is by your lights, the talks are unsuccessful, then what do you recommend this country do—Congress or the administration or both?

Mr. KERTZMAN. Well, at this point I am hesitant to recommend a Super 301 response because that has been a very controversial item in our organization. Our Board of Directors did not approve the Super 301—putting Japan on the Super 301 list. We voted that. I would be reluctant to, as an individual, without the endorsement of my Association, to suggest that here.

Senator BAUCUS. Okay.

Mr. Pickens, what about investment restrictions to Japan. How are we going to open the doors on it?

Mr. **Pickens**. Well, of course, I want to see them open up and give us the same entry into the Japanese markets that they have into our markets here. You know, I am not in manufacturing and I am not selling anything in Japan, so I have a different perspective than the other two panelists here. But there is no doubt that we have real problems in achieving representation after making a huge investment.

As to the date, I do not know what date I could give you on that. But my advice is simple—let's quit screwing around with these people and let's get down to hard trading with them and give somebody some strong measures that they can deal with because they are rolling us at every meeting because our trade representatives are going in with nothing to trade with and the Japanese know that.

Senator **Baucus**. What other examples are there in addition to your company and investment restrictions in Japan? I am trying to get at how widespread the problem is with, say, major investors like yourself trying to take a position and became board members.

Mr. **Pickens**. You cannot—you know how corporate Japan is set up. It is really a closed shop. Just look at this illustration over here. You can see the red around approximately 65 percent of the circle there and the red represents what is identified as stable stockholders. Those people never sell; they never communicate. You cannot get in. That really is descriptive of corporate Japan.

So their financial markets are closed to us. I am not trying to take over a company there. I have been very forthright and upfront about it. I made an investment. We are not trying to greenmail the people. We told them that we wanted to be on the Board; we were long-term shareholders; we asked them to give us a chance to participate and they will not do that. They will not open themselves up. They will not let us on the Board.

So when you say, how do you get in there? Their financial markets are basically closed on everything to us there. There is nothing open to us. Yet, the Japanese continue to march forward in America, continue to buy. It is almost like being in a store with all kinds of enticing items on the shelves and they are just going down the isles stuffing their baskets with America—that is what it amounts to. At the same time, we cannot go the other direction.

Senator **Baucus**. Okay.

Mr. Leland, I will ask you, what are your standards, by when, what's the alternative?

Mr. **Leland**. Okay. Well, I would like to separate Super 301 from the SII. I think the SII is longer term in nature by the very kinds of things that it has to deal with and I am unable to give you specific standards or specific time frames. But I think we should view the SII as an ongoing process and that progress needs to be made and if it is not, action should be taken.

With regard to Super 301, I think that we should expect $1 billion to $2 billion in incremental forest products trade by the year 1995 as a result of Super 301. That should be our minimum target.

Senator **Baucus**. Which of the two forms would be most productive—Super 301 or the SII—in the long run do you think?

Mr. LELAND. Oh, I think clearly in the long run that if significant changes can be made in the Structural Impediments, then there is little need for Super 301.

Senator BAUCUS. Is it true that immediately following the San Francisco/Oakland Bay area earthquake an agency in Japan was trying to spread the word that all the wooden structures in the Bay area collapsed? Is that true? I heard that somewhere.

Mr. LELAND. I did not personally see the press report, but I understand the Fire Marshall from the city of Tokyo put out a press release that basically said that the changes in wood products, building codes, that were allowed under the MOSS talks of a few years ago were bad because all of the or a great number of the wooden base structures in San Francisco collapsed as a result of the earthquake.

Now as I understand it, the fire marshal in San Francisco, indicated that he (the fire marshal of Tokyo) was talking about some other earthquake because the loss to wooden structures as a result of the earthquake was slight. In fact, wood structures built under the building codes within the last 20 years performed very well.

Senator BAUCUS. Have you read the VonWolfren book about Japan?

Mr. LELAND. I have not. I must admit, I have not, Senator. I have it on my desk. But it has not gotten into my briefcase yet.

Senator BAUCUS. Well I am reminded of his statement about the relative realities that he sometimes sees in Japan, that often lots of red herrings strewn across the negotiating table are different. In other words, the assumptions behind the talks are always changing because reality is always changing from Japan's point of view. I must say instances such as this tend to indicate that. I am thinking of another one. We have all heard of it. That is, that foreign skis cannot be sold in Japan because Japanese snow is different.

Mr. LELAND. How about the length of the digestive track?

Senator BAUCUS. I was just getting into that.

Mr. LELAND. Yes.

Senator BAUCUS. That is the next one. It is sad when one hears these statements because they are illogical and they seem to indicate some lack of good faith in trying to reach a negotiated solution.

Japan is a signatory to the GATT. Free trade is the underlying premise of the GATT. It seems to me, therefore, that even if there are cultural differences between our two countries—if Japan and the United States are both signatories to the GATT, both countries working under the premise of free and open trade, certainly Japan should not indulge in these shifting changing realities and changing assumptions.

The fact is, the world is always changing and the world always will change. This country has adjusted dramatically. The American automobile industry has made very dramatic adjustments and I think too that Japan too must make very dramatic adjustments to the realities of the world so that both countries can mutually gain economically. But a large part of that is Japan recognizing that one of the assumptions of the GATT is open free trading, and logical, agreed upon solutions to problems.

Mr. PICKENS. But the Japanese are very adaptable and adjustable around the world, except at home.

Senator BAUCUS. We are going to have to deal with that.

Mr. PICKENS. I am not optimistic about SII or 301, either one. I think Congress has got to come up with some legislation that does the job.

Senator BAUCUS. Well on that point, Mr. Pickens, 301 is the brain child of the Congress—301 came from the Congress. This Congress enacted Section 301; this Committee originated Section 301. And frankly, I think Section 301 has gone a long way to open up markets around the world, including Japan.

Senator Rockefeller.

Senator ROCKEFELLER. And what markets have they opened up in Japan? Oh, I am asking in the wrong direction. I am sorry.

A couple of questions. Are we going to have several rounds, Mr. Chairman?

Senator BAUCUS. Sorry?

Senator ROCKEFELLER. What is our time limit here?

Senator BAUCUS. Oh, you can go as long as you want.

Senator ROCKEFELLER. All right. [Laughter.]

It is said that for $17 billion, between 1950 and 1983, in 42,000 separate transactions, Japan obtained virtually all the technology in the world worth having, and the Japanese miracle occurred with the research of the U.S., basic research, at its base. I take nothing away from Japan, but it was the result of this technology purchase as well as cross licensing, which means we will invest in your small business if you will give us your technology. We were in the position to say no but did not.

Now you can look at that in either of two ways. You can say the Japanese bought our technology, or you can say that we sold it to them. If we sold it to them, it was probably based upon an arrogance that it would not make much difference.

Mr. Kertzman, in your own particular case with your industry, how do you defend that statement?

Mr. KERTZMAN. Well, it is your statement. The issue of what they have bought—let's just say perhaps that in many cases technology was licensed. And perhaps I would say in many cases the Japanese have assumed that there was more given with the license than we assumed there was given. There is a lot of instances of that.

Senator ROCKEFELLER. Does that mean that our lawyers were not as sharp or what?

Mr. KERTZMAN. It means perhaps that we were naive. I would say that there is probably a long track record of trust and naivete on the part of American companies that I think you will find a lot less of than you used to.

I will say, however, that the record of the Japanese advances in technological competition is an excellent example of how adaptable the Japanese really are when they really want to be adaptable. I think if you look at the history of the Japanese from post-World War II to the phrase "Made in Japan" and all that meant to their understanding, that quality was important to competing in the world and their change in their entire culture of manufacturing and productivity to focus on that goal, it shows how good the Japanese really are at working toward a goal and changing things when they perceive it to be in their interests.

Our need now is to show that there is a different way of behavior that is in their interests. I think we should not think of ourselves. When we think about buying less from Japan, you know, that is called protectionism. I would say to you that we are a customer of Japan. We are also a competitor. When we say to Japan, if you do not do certain things, we will not buy from you; that is not protectionism, that is being an unhappy customer. The Japanese should look at the United States as a growing, unhappy customer.

Senator ROCKEFELLER. Don't you agree that the Japanese really never do anything unless there is a date certain and a specific threat of retaliation? An this, in turn, creates tremendous ill will in Japan, but, on the other hand, it is the only thing that really seems to work?

Mr. KERTZMAN. I would say that there is a track record that—I cannot point to a track record that says, dates certain and threats work. What I can say is, the only thing that seems to work is when the Japanese perceive something to be in their self-interest. From that point of view, we have to structure our relationship with them to make it obvious that what we want them to do is in their self-interest, whatever those options are.

Senator ROCKEFELLER. There are two schools of thought. One is held by Carl Von Wolferen and there is another school of thought held by others, including some on this committee, although not the two Senators present. That is, that the Japanese economy is so highly leveraged that it is a house of cards doomed to collapse.

That is not my view. I think they have a house of steel with a system which is probably unstoppable for the foreseeable future. Therefore, the question is: What is it that triggers their self-interest, to make them conform to what we would call reasonably open markets or an instinct for opening? What do you think is necessary to convince them that something is in their self-interest when the economics make it hard to prove that it is in?

Mr. KERTZMAN. I, for one, think that what we have to trade with is in effect we have our markets to trade with. I would also say that the European communities——

Senator ROCKEFELLER. In other words, you mean you would up the voluntary restraint agreement on automobiles or steel or what? I mean, what would you withhold?

Mr. KERTZMAN. I would not make any specific suggestions, other than to say that is one of the things we have.

Another thing we have, I would say, is that we have a developing market opportunity in the European community and that one of the things that we have as a way to deal with the Japanese is we have our friendship with the Europeans and that there is some opportunities there to demonstrate positive corporate partnerships and country partnerships and behavior. Let's just say that the United States and Europe represents two extremely large markets and that there is a powerful weapon there.

Senator ROCKEFELLER. Some people say that EC–92 may drive the Japanese and the Americans together to take on the Europeans.

Mr. KERTZMAN. Well, the Japanese say that. I find that a scenario that is hard to imagine right now.

Senator ROCKEFELLER. Yes. I think I agree with that.

Look at orange juice. Our negotiators worked very hard to open up the market for our orange juice and then the Brazilians move in—take 85 percent of the import market in Japan. In the case of Taiwan, we were negotiating with them on chocolate, opened up the market, but did not adjust our chocolate and the Japanese moved in. So, sometimes when others open up a market, the question is: Are we prepared to fill the nitch? The market is open, but who moves in? Is that of concern to you?

Mr. KERTZMAN. It is a tremendous concern to me. That is why I said in my testimony that I believe we should focus not only on what the Japanese are doing, but on our preparedness. For example, what I focus on mostly in our association is the phenomenally high cost of capital and the lack of patience of capital in this country. That no matter what you do with the Japanese market, if we continue to have a cost of capital disadvantage of three or four times, then we will continue to be unable to be competitive except in innovative products like this Motorola phone. Which, by the way, Motorola cannot sell in Japan, despite the fact that it is the best in the world.

I think that we need to pay attention to our own house and the cost and the availability of patient capital is going to kill us around the world no matter what we do in SII or Super 301 or anything else.

Senator ROCKEFELLER. What would be the most significant thing we could do to bring down the cost of capital in this country?

Mr. KERTZMAN. I think you are looking at the Federal budget deficit as the single one. That points to one.

Senator ROCKEFELLER. How would you have us do that?

Mr. KERTZMAN. Without being disrespectful, I believe that is what we pay you for.

Senator ROCKEFELLER. No. I know that. [Laughter.]

I know that. But we asked you to be a witness to answer questions and that is not a helpful answer. [Laughter.]

Mr. KERTZMAN. What I would say is, that we have a, in my opinion, difficulty in dealing with the long-term problem with the Federal budget deficit, which is that the Federal budget deficit and the constraints of Gramm-Rudman are preventing all of us—both you in Congress and the community which you represent—from collectively thinking long term. In other words, we have chosen to look at the budget deficit as of this year, next year, et cetera. And as a result, we are not focused on the long-term issues here.

As a result, if I say to you, I believe that there should be a preference for capital gains—to take an example of something that our Association is in favor of—you will say, well, I think that loses money; how are we going to pay for it? We totally lose the question of whether a preferential capital gains policy is good economic policy.

To that extent, I believe that the issue here is an issue of administration leadership and congressional leadership and that it is very difficult, for instance, for me to single-handedly say that the electronics industry is willing to give up the R&D tax credit and the capital gains preference and everything we fight for while other people may be sitting at the table saying, well, let's thank the electronics industry, but in the meantime we want our preference.

Getting all of us to drop our own self-interest is something that requires leadership to provide. I think that leadership has to come from the government.

Senator ROCKEFELLER. Mr. Chairman, let me make just one more statement. I know my time has run out. I would like to agree with what I think Mr. Pickens was saying—that this whole SII exercise is a sham.

Mr. PICKENS. No, I don't believe—I just don't——

Senator ROCKEFELLER. Well then maybe somebody else said it.

Mr. PICKENS. No. I said I didn't think we were going to get much out of it.

Senator ROCKEFELLER. Yes.

Mr. PICKENS. But I did not go so far as to call it a sham.

Senator ROCKEFELLER. Yes. But I think it is. I think that, in spite of the good work that we did here to devise Super 301, the Japanese see SII as a dialogue which is not going to lead to anything. Again, there is no time certain and no clear action by that date. They are going to talk about our budget deficit; we are going to talk about the Fujitsu one yen bid, and so on. So we will go back and forth, but there will be nothing really specific that comes from it.

There maybe one good thing to come from this—that we will be forced to recognize, somewhat against our will, that we are going to have to find how to deal with the Japanese in a way that works for us as well as for them. That is going to be a difficult process and will take a long time. The Japanese are not accustomed to giving in. Their acceptance of foreigners over the years has not been very distinguished, although their acceptance of foreign ideas has been very distinguished. But they are not going to give up on their success, and, if one takes a narrow, shor-term view, there is no reason why they should.

Tragically, we have not yet in this country mastered how to make trade part of our bilateral relationship with Japan. It is still fundamentally at the State Department and the NSC. Secretary Mosbacher has done the best that he could, but he has not been able to prevail. Ambassador Hills is still going through what Clayton Yeutter was going through in his first couple of years, that is, trying to deal as if Japan were following the same rules as we are, and they are not.

I note that Korea and Taiwan made significant adjustments; to escaped designation under Super 301. The Japanese really couldn't, even if they wanted to, because of the problem with the LDP, political instability at the time, and plus their structural and cultural problems.

Let me stop there, Mr. Chairman. If there is going to be another round, I would like to participate.

Senator BAUCUS. Thank you, Senator.

Mr. Kertzman, you mentioned that high cost capital is a major impediment. I agree with you. I do not know that there is anyone in this country who would disagree with you. Yet you also heard Mr. Archey say that even if America does everything right, still there is going to be a major problem here.

Mr. KERTZMAN. Right.

Senator BAUCUS. Do you agree with that?

Mr. KERTZMAN. Yes, I agree with both sides. In other words, if Japan does everything right and we do not adjust some of our problems here, we will not achieve our goals; and, if we do everything right and they do not do everything they are supposed to do, we will not achieve our goals. It has to be bilateral.

Senator BAUCUS. Mr. Pickens, could you please delineate a little more fully the interrelationship between the Japanese investment barriers on the one hand and trade barriers to U.S. products on the other. That is, if Japanese investment barriers were eliminated, perhaps U.S. investors on Japanese Boards could see new opportunities to sell American goods.

Mr. PICKENS. Well, let me say this, I feel expert in one area and somewhat of a novice in the other. But you cannot believe the response; I almost understand what it must be like to be a Senator after hearing from so many people on this issue at I have gotten myself involved in. I hear from CEO's of substantial corporations in America, and I hear from individuals and it is incredible. But 100 percent of the comments are supportive of what I am trying to accomplish. I get no criticism.

In all the other things I have ever undertaken in business for all my life, there are usually two sides. In this one, there is only one side. I hear the Japanese say that our products cannot compete. My response to that is, let them have a chance. If we cannot compete, well, so be it—we do not sell our products in the Japanese market. But let us have a chance to come in.

I was down at Memphis the other day making a speech and I bumped into the Federal Express people. They said it is incredible. They said anything going into Japan—and you all have heard these stories—I know that they look at every—inspectors open every parcel and inspect it there and the inspector has to draw a picture of the contents. In this high tech era that we are living in, somebody draws a picture? No better than I can draw, I could not get through more than three parcels a day. And I believe that story.

You hear one right after the other. Let me speak just a second to how well the Japanese have adapted to our financial markets in America. They have looked at it. They see the opportunities here. They see the undervaluation of assets and they want to be in on what is going on. They are in all facets of it. They are participants in LBOs in a nonoperative position, but just a participant. In many LBOs the Japanese banks are participants. You have them in as the primary participant in some deals. You have them in all, really, all of our financial markets in America. They have adjusted very quickly to how to play that game and they are in the deals.

At the same time, I ask for just simple representation on a Board after we have 26 percent of the company. I asked for four seats out of twenty. There is no way that I can have a great deal of influence with four seats out of 20—20 percent of the Directors on the Board. But I believe that I am due that representation and it is not even taken serious. They will not cooperate at all—I had one meeting with the management and it lasted only 15 minutes. That was all.

Senator BAUCUS. Again, is it your view that if a Japanese company were more open, it would probably be dealing less on a sweetheart basis with other major suppliers or customers, and its shareholders and consumers would be getting a better price? Is that a fair statement or not?

Mr. PICKENS. Well, look at the price that the Japanese consumer pays. We know they pay twice as much for Sony television. We know that a Toyota car costs $15,000 more than it does in the United States. We know that the Japanese buy items in Hawaii and smuggle them back into Japan because they are cheaper to get back in that way. What is going on here? Why is it that I can buy a Toyota car in Dallas, Texas for $15,000 cheaper than somebody can buy one in Tokyo?

Senator BAUCUS. The result is, that gives that Japanese company unfair disproportionate market powers in the United States, because it is selling at twice the value to its Japanese consumers; therefore, getting——

Mr. PICKENS. That is exactly right. I think the middle class in Japan is catching on. We know. We have seen what has happened to the eastern block and China. With modern communications—a FAX, a TV and all—the Japanese are learning that their standard of living is below that of America. It just is not up to the U.S. standard. I think that this will create some real problems for the Japanese leadership, that the middle class is going to get tired of this.

Senator BAUCUS. Very briefly, Mr. Leland, how is Super 301 working? Would you make any changes or suggest any changes to the administration?

Mr. LELAND. Well, it has just gotten started. As it started, we felt a great deal of enthusiasm on the part of the Department of International Trade and Department of Commerce. We see, as of currently, a little bit of that enthusiasm waning. Maybe it is because they have too many other things on their plate. Maybe it is because the task, as everybody here has said today, is gigantic and difficult. But we see that enthusiasm waning.

Senator BAUCUS. Where?

Mr. LELAND. In the ITR.

Senator BAUCUS. Can you be more specific? Where is it waning?

Mr. LELAND. Well, I think just with the effort itself. We need to get that pumped up and get back on track. We are going to be calling on you and others to do that.

Senator BAUCUS. My time is up.

Senator Rockefeller.

Senator ROCKEFELLER. It is fascinating because Japan is the story of a society which, for the whole Tokugawa period, was an entirely closed society. For example, there were some Dutch traders who were allowed to live on an island off southern Japan. If one died, they could not be buried on Japanese soil.

The Japanese after the Vietnamese War, our war in Vietnam, infuriated many in Asia and around the world by refusing to take but a handful of refugees. In recent years, their policies toward Southeast Asian refugees has changed some what.

There is also the whole story of Koreans in Japan. I was a student in Japan, went to the university there, and learned the language. The story of the way the Koreans are treated there is redolent with the kind of racism of which they accuse us.

We may rail at them, or offended and infuriated by the fact that we put them back on their feet and now there is a new generation there. If you think that the Japanese we are negotiating with now are tough, wait until the younger generation comes along. They do not remember the post-war period, and they are going to be a lot harder. They have the world going their way. Societies tend to move in cycles. They are cycling up; we are moving down right now, in a relative sense, as we try to come to terms with this post-war era.

They go to school 6 days a week; we do not. Toyota opens up a plant in Georgetown, Kentucky, and, they say, we will come, but we want the kids of our people to be able to go to school 6 days a week. That is a pretty smart thing to ask. Now I think some of the Kentucky kids are going to school 6 days a week in that particular County.

There are 13,000 researchers here at any given time. They are in our government and university labs. They can take everything they want back home, yet we have very few people over there. I worked hard to get a new Science and Technology Agreement, and watched it very closely. Finally, we get the agreement, and what does it mean? Well, we will see how good we are at competing by how we take advantage of the new agreement.

We fight to remove some of the restrictions on the way imported automobiles are examined in Japan. And who comes in, the Germans and other Europeans, to take that nitch. So the next question is then: If we get Japan's markets open, what are we going to do about it?

Mr. Chairman, it is kind of an overall sense of tremendous frustration with Japan. They are not going to change in my judgment; we have to change enormously. But even if we do, they still may not be penetrable because of the cost of capital. We will never get the cost of capital down to where they have it. We do not have the keiretsu system. We cannot go to NEC, the largest builder of computers in the world and the Sumitomo system and get low-interest loans. We don't have a system to give a company 10 years while all the other businesses in the group help with their cash position. We do not have that.

So the broader question to me is: What heaven's name do we do to work out a system wherein we can deal with Japan? I do not see such a system developing. Therefore, the only answer that seems to occur is gaiatsu, foreign pressure, the very thing which made their high school kids say in an Asahi Shimbun poll a year or so ago that they expect the next war to be with the United States—a majority of the junior high school kids polled expect to go to war with the United States during the course of their lifetime. It is absolutely incredible. Yet we have polls in the United States with a similar message—that Japan is considered a greater threat.

I really wonder what we are doing. Our emphasis is on the short-term profit that several of you have mentioned. How do we change that in our system?

The first bill that I ever worked on in 1985 when I came up here was to try to get American businessmen to read Japanese technology literature, 10,000 journals a year. We will not read them. Why? Because they are in Japanese. Do we speak Japanese? No. Can we translate into Japanese? Yes. Do we do it? No.

There was one free enterprise group in Michigan trying to translate Japanese technical journals for the use of American industry—from superconductivity to air conditioning to whatever you wanted—and they went broke last December. They went broke. So now we are trying to do it through the Commerce Department. It is a real quandary.

Senator BAUCUS. Thank you, Senator. I am glad you mentioned that bill. It was my bill. [Laughter.]

Senator ROCKEFELLER. That is interesting. I thought it was my bill. [Laughter.]

Senator ROCKEFELLER. It shows that we work together.

Senator BAUCUS. Senator Symms.

Senator SYMMS. Thank you very much, Mr. Chairman, and members of the panel. I apologize. I was not here for your testimony. I will take the testimony and read it—and also for the first panel that testified. I was tied up with the Republican leader on another matter over in the cloak room so I missed the first part of this.

I think maybe, so that I do not ask redundant questions, that I will just not ask any questions right now and read all the testimony and thank all of you for making the effort to be here to share your insight with us.

Senator BAUCUS. Thank you, Senator.

Senator Rockefeller, any other questions?

Senator ROCKEFELLER. Max, let me just ask one more. Boone, what do you think we ought to do? We have Super 301. The Congress can sit here and pass any law in the world we want to. What do you think we ought to do?

Mr. PICKENS. Well—and you know where I am going to go up from as a business man, and I have been in a lot of negotiations, and I have made a lot of deals in the past. But the first thing is, is that I try to find analogies to the problem we have here. What I find is the build up of defense during the Reagan administration and what happened to us that we now can negotiate with the Russians and they want to disarm.

I think here you are going to have to come up with something strong so we can bring them to the table. I really believe that the Japanese must laugh at us when they come for trade negotiations.

Senator ROCKEFELLER. They do.

Mr. PICKENS. Yes. I mean it is a joke. I do not like being a joke. I think you get our people ready to go, sit down and talk real business with them.

Senator ROCKEFELLER. And do what? Do what? What can you do in Super 301 other than literally putting up barriers which——

Mr. PICKENS. I think that is what you are going to come down to. You know, I am a free trader. I really believe in free trade. I believe in a global economy and I believe if you cannot play in the league you will have to go play in another league. But you cannot send a team out on the field, like you are going to go out and play the Redskins. You do not go out without pads on. If you just put on the jersey and the pants and the shoes without socks, the game is going to be over in the first 5 or 6 minutes because all your people are going to have broken bones. You do not go out to play hard ball with somebody unless you have a glove.

That is where we are right now. The Japanese just burn it in and we are sitting there just bare handed trying to handle this thing and it is not working.

Let me tell you something that really does concern me about what I believe is going on. The Japanese are exporting their cartel in the United States. They are bringing in the factory and they are being very clever about the way they do it. They are moving around all over the United States and with it they are gaining political influence. But at the same time all this is going on, they are also bringing in their parts manufacturing people right behind them.

I mean, you have talked to our parts manufacturing people in American, they cannot get into this business. So they bring their cartel in. They have the whole stream there, right up the line. And then I think that the thing you are getting ready to see now is, just as soon as you see the European markets opened up in 1992—the Japanese have had real problems getting into the European markets—they are going to go into the European markets as "Made in America." They are going to ride in on our good will and our coat tail and they are going to be part of what we get in the European markets and they will just export it right through here and right on in.

It will be made in the United States, but it will be the Japanese doing it. They are going to move it right in to those markets.

You know, this is a great concern to me. When I look over at Toyota, which in this particular deal up here, if I might refer to it one more time, Toyota and Koito, the relationship is Koito is a subsidiary of Toyota. Toyota pulls all the strings over there. They have a former Toyota man as a CEO. They have three Directors on the Board. They run the company is what it amounts to. Toyota is sitting there with $20 billion now in cash. Now where is the $20 billion going to go? They announced 30 days ago they are going to double their car production in the United States, and the next day I pick up the deal where Lee Iaccoca says he is going to cut down production at Chrysler.

What is the deal here? We are losing jobs on one side, creating jobs on the other side. There are only going to be so many cars made. There are going to be only so many cars purchased. Why are we going to turn all of this over to the Japanese if we get nothing in return? It is not a trading relationship. We are getting picked like chickens. This is pitiful.

Senator BAUCUS. Frankly, I think we have no choice but to exercise the market power that we do have. Jacques DeLors, the EC President has said publicly that he is not going to let happen to the EC what has happened to the United States. He is not going to let Japan take advantage of the European community in the same way that Japan has taken advantage of the United States.

The point being, that if he is successful in not letting Japan do to the European Community what Japan has done to the United States, then Japan still has to look at the American market to sell a lot of its products. The more we can exercise that leverage and do, in fact, exercise that leverage in America, then the more we do have a club which, in fact, is effective. That is, we are not a paper tiger; we are backing up our words.

We have no choice, it seems to me, but to exercise the leverage that we do have. Otherwise, we can accept the status quo and we know the status quo is worse than trying to say that——

Senator ROCKEFELLER. You know, Max, the last two or three times that I have been in Japan, I sat down with Presidents of major trading companies, in off the record sessions. Do you know what they told me? They said, we wish that you would have passed the Gephardt Amendment. Because at least that held out to us a figure and a date. And it says, by such and such a time you have to be at such and such a point, either by increasing imports or reducing exports. Interesting.

Senator BAUCUS. Thank you very much, gentlemen. We appreciate it.

Our final panel includes Mr. Don Spero, president of Fusion Systems in Rockville, MD; Julian Morris, president of Automotive Parts and Accessories Association, Lanham, MD; and Mr. Thomas Howell, counsel for the American Natural Soda Ash Corp., here in Washington.

Mr. Spero, you are next. Where are you? There you are.

## STATEMENT OF DONALD M. SPERO, PH.D., PRESIDENT, FUSION SYSTEMS CORP., ROCKVILLE, MD

Mr. SPERO. It may surprise you to hear this, but I come before you as a friend and admirer of Japan, in spite of the problems we have had there. Fusion Systems has very important and valued customers in Japan. We have key vendors in Japan. We have our own excellent employees in Japan.

We began working in Japan a number of years ago. We are a successful, private $33 million company. We export worldwide. A third of our business is export and half of that export is in Japan. We have been very successful in the Japanese market where we dominate the niches where we have chosen to compete.

We entered the Japanese market in 1975 and in 1977 Mitsubishi Electric Co. purchased and reverse engineered one of our products, a high power ultraviolet lamp system which is used to manufacture semiconductors, optical fibers, automotive parts and many other products. A few months later, Mitsubishi began to file a flood of patents in the field of high intensity microwave lamps.

To date, they have filed nearly 300 applications and these attempt to copy and surround our technology. Some of these seek to patent designs in the lamp system which they purchased from us. Others represent attempts to secure patents on information clearly in the public domain. And in a third category, others claim so-called "improvements" on our technology that more accurately represent trivial modifications.

One of just many examples: Mitsubishi has applied for a patent on an electrical circuit which is a direct copy functionally of something that was in the manual of the product that they purchased from us.

These tactics, interestingly, have not been attempted by Mitsubishi in the United States or in Europe, where we also hold patents and dominate niche market shares. If these patents that they have applied for are awarded in Japan, Mitsubishi is likely to assert that Fusion can no longer make even the lamp that they purchased from us in 1977 in order to start their program. If that does not define patent flooding and patent fraud, I do not know what does.

The Japanese patent system not only permits but invites this kind of behavior on the part of large and powerful corporations.

Clearly, Fusion has collided directly with a massive structural barrier in the form of the Japanese patent system. Most Americans with experience in Japan readily acknowledge this problem, and increasingly, U.S. companies are beginning to discuss the issue publicly.

Former U.S. Patent Commissioner, Donald Quigg, said of the Japanese patent system that it, "acts as a formidable trade barrier to foreign business."

Increasingly, members of this Committee, of Congress and the administration, are recognizing that intellectual property is a critical element of the trade and competitiveness issue. A majority of the most valuable American innovation comes from small businesses. Targeted innovators most often license their technology to assure themselves at least a small share of the market. This practice is so common that former Commissioner Quigg said of the Japanese patent system, "They indirectly have a massive mandatory licensing system."

Regis McKenna estimated, and Senator Rockefeller earlier referred to this data, that between 1950 and 1978 Japan paid $9 billion for some 32,000 technology licenses from predominantly small companies—inventions that cost the United States as much as an estimated $1 trillion to develop.

The cost of this loss of our intellectual property base is enormous. Most structural barriers to trade result in a current loss of sales with a resulting unfavorable effect on the current trade balance. With the loss of intellectual property, however, we not only lose today's market but suffer an amplification effect into the future. The jet engine, the transistor, and optical fibers are but a few dramatic illustrations of how technologies that may seem small at first can become the foundation of entire industries in the future.

The FSX debate focused congressional attention on involuntary technology transfer and the relationship between competitiveness and defense procurement policy. The Office of the U.S. Trade Representative, the Departments of Commerce and State and the Patent and Trademark Office have demonstrated active leadership for securing effective protection of U.S. intellectual property in Japan. They have kept their doors open. They have sought our views and expressed support for our efforts in Japan.

But the Japanese, as has been mentioned here already, have developed a winning strategy and they will not change it without significant external pressure.

A survey of 1,500 Japanese businessmen, conducted by the American Electronics Association in Japan, indicated that 68 percent of those polled felt that Japan would change its policies only as a result of foreign pressure.

The challenge for U.S. policy is to develop constructive but powerful incentives for such changes in Japan. Some already exist. For example, it is clear that Japan would benefit from the growth of innovation and entrepreneurship that it would experience if small Japanese leading edge technology companies are allowed to create and commercialize their own inventions.

In closing, I will say that the Japanese Government must be persuaded, in the context of SII talks or otherwise, to upgrade their system of intellectual property protection to the standard of those in Europe and in the United States, where innovators can operate with a reasonable expectation that the fruits of their R&D will not be routinely misappropriated, and where, with skill and hard work, businesses can reap the rewards they deserve and continue to reinvest in technologies of the future.

[The prepared statement of Mr. Spero appears in the appendix.]

Senator BAUCUS. Thank you, Mr. Spero.

Mr. Morris.

## STATEMENT OF JULIAN C. MORRIS, PRESIDENT, AUTOMOTIVE PARTS & ACCESSORIES ASSOCIATION, LANHAM, MD, ACCOMPANIED BY LINDA HOFFMAN, VICE PRESIDENT, GOVERNMENT AFFAIRS AND INTERNATIONAL TRADE

Mr. MORRIS. Thank you, Mr. Chairman, for this opportunity. I have taken the liberty of asking our Association's Vice President of Government Affairs, Linda Hoffman, to accompany me.

Our presence here today, in support of the Structural Impediments Initiative, continues are Association's long quest for more openness in the Japanese parts buying and distribution systems.

Near the beginning of the decade, this subcommittee convened to hear about the burgeoning bilateral automotive trade imbalance. Despite major efforts since then, by our Association, by the government and teams of U.S. negotiators aided at increasing two-way trade and shrinking the imbalance, I regret that the deficit has swollen dramatically, nine fold in the last 8 years.

That hearing in 1981, held on the even of Tokyo auto parts negotiations, parallels today's hearing on the eve of both the SII round and a post-MOSS followup meeting in Tokyo. At that time, then Deputy USTR McDonald told this subcommittee that U.S. negotiators would convey the seriousness of Congress's concern over the perceived lack of access to the Japanese market. APAA hopes, Mr. Chairman, that this hearing will spur the delivery of that message once again in volume and tone that simply cannot be ignored.

During the 1980's our industry has faced the compounding impact of three import waves that have contributed over a third of the United States-Japan trade deficit. First, there were torrents of direct and captive import cars which continue today. Next came the imported car plants which used American labor to assemble vehicles largely designed in Japan and made of import parts. These Japanese vehicles have displaced traditional high U.S. content cars, eroded U.S. parts markets and left us with growing excess capacity.

Already vulnerable, our industry now faces its gravest threat from a third wave, consisting of hundreds of foreign parts producers moving on shore. With Japanese cars taking increasing shares here and globally, we continued to be greatly troubled by a Japanese auto industry structure that the USTR's 1989 trade barriers report says "precludes," or rules out in advance the use of otherwise qualified and competitive U.S. original and aftermarket suppliers.

We believe the structure of Japan's automotive industry long has excluded U.S. firms from equipping Japanese cars that dominate the world market. Car company headed industrial financial groupings intertwine Japanese car companies and suppliers so tightly that their parts makers are likened by one Japanese newspaper as faithful servants of a feudal warrior chief. These keiritsus, as the Japanese call them, are the foremost structural impediment we know of in United States-Japan parts trade.

Although the 1980's have been punctuated by three key U.S. Government initiatives to crack these keiritsus created barriers, United States-Japan auto parts trade figures signal failure of increasing proportion.

Japan's closed parts distribution web has joined the closed parts buying system in the United States It remains difficult for America's independent aftermarket, retailers and service outlets to provide a full line of replacement parts to owners of Japanese nameplate cars. Tightly controlled Japanese parts suppliers generally restrict replacement parts sales to the car dealer network only. And, since most United States and other independent parts makers do not have the economies of scale that original equipment sales equipment provide, tool up costs for production of many replacement parts can be prohibitive.

Gaining a fairer shake at supplying the Japanese car building and aftermarket service parts markets in the United States, Japan and third markets was supposed to be the overriding goal of the United States-Japan transportation MOSS negotiations that concluded in August of 1987. MOSS failed in its primary goals of reforming Japanese sourcing practices in large part because of the control we allowed Japan to exert over the agenda itself.

Five of the seven negotiating sessions were mired down by the issue of how Japan would self-monitor post-MOSS progress. Rather than crafting a system that measures the genuine successes of traditionally excluded U.S. firms, the agreement our government endorsed allowed Japan credit for purchasing from their transplanted traditional suppliers now locating in the United States.

This means our government is effectively rewarding Japan for keeping the same tight bonds that the negotiations were intended to loosen.

We relate this experience at today's hearing on SII because we hope it will be instructive. Ambassador Hills' modest expectations for an SII generated "blueprint" for change and a "downpayment" of reform by next summer are not quite enough.

In 1980, Japan produced a parts trade "blueprint" calling for broader American access to Japanese original equipment and repair parts markets. The modest "downpayment" was a pledge to increase U.S. parts imports to $300 million in 1981 and significant increases thereafter.

Despite the blueprint, however, it was not until 1988 that Japanese imports of U.S. parts finally passed the $300 million mark, a rather paltry sum in relation to the $9 billion parts trade deficit between our two countries. And at that, the goal was reached by allowing Japan credit for purchases made from their own plants now operating in the United States.

APAA believes that the SII must move us well beyond blueprints and downpayments to accelerated payments and a trade structure that assures fair commercial consideration.

We have high expectations for our SII because it stands on the Super 301 foundation, which the 1988 Trade Act architects built as a no-nonsense, results-oriented approach towards correcting trade abuses. Our recommendations, which we have provided your staff and which will be included in our full statement for the record, are results-oriented also.

The SII, the post-MOSS talks and the Trade Act's new 5-year Japan parts market initiative should buttress one another, adding strength to our appeal to the Japanese Government for structural changes in Japanese procurement and distribution practices.

The Japanese Government should be reminded that, thanks to the potent new Riegle/Levin amendment, the trade law holds foreign governments accountable for the lack of fair commercial consideration for U.S. products. As Senators Riegle and Wallop have noted, government toleration of discriminatory industry practices is just as damaging to U.S. exports as a direct action by the government.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Morris appears in the appendix.]

Senator BAUCUS. Thank you very much, Mr. Morris.

Mr. Howell.

### STATEMENT OF THOMAS R. HOWELL, COUNSEL, AMERICAN NATURAL SODA ASH CORP. (ANSAC), WESTPORT, CT

Mr. HOWELL. Mr. Chairman, I am Thomas Howell. I am an international trade attorney at Dewey, Ballantine, Bushby, Palmer and Wood, and I am serving as counsel to the American Natural Soda Ash Corp. or ANSAC. ANSAC is a Webb-Pomerene Corp. that represents the whole U.S. soda ash industry, the six producers of soda ash.

I am presenting testimony today on behalf of John Andrews, the President of ANSAC, who could not appear in person before the Committee today. But I am also prepared to answer questions about soda ash and the problems it has encountered in Japan over the years.

The United States enjoys a natural resource advantage in soda ash. We can produce higher quality soda ash than any other country in the world, higher quality at a lower cost. In any open competitive situation, our industry is likely to prevail. However, we have never confronted an open market situation in Japan. We attribute the partial success we have achieved to date to the long standing efforts of the U.S. Government negotiators on our behalf as well as some significant actions by the Japan Fair Trade Commission.

However, while U.S. soda ash sales have increased in the past several years, our sales are still regulated, to a degree, by a group of Japanese soda ash producers and their affiliated trading companies.

Japan has a long history of resistance to import penetration in soda ash. In 1983 the Japan Fair Trade Commission, after investigation, found that an illegal cartel of Japanese soda ash producers organized in 1973 was restricting sales of U.S. soda ash in Japan. The JFTC found that these firms regulated the price of soda ash in Japan, allocated market shares and import shares among themselves, and shared the profits and losses among themselves according to an agreed ratio. They did not compete with each other.

The Japanese producers exerted pressure on Japanese soda ash consumers not to procure imported soda ash through independent channels—that is, by just buying it from the Americans. They were required to buy imported soda ash from the producers group itself, from the Japanese cartel. The JFTC exposed this activity, ordered the Japanese producers to cease it, although it imposed no other sanctions or fines of any kind. It simply told them to stop doing it.

In the immediate aftermath of the JFTC decision, U.S. sales increased from an annual total of about 50,000 metric tons to approximately 200,000, 210,000 metric tons per year, which is about 18 percent of the Japanese market.

After that, however, U.S. import volume leveled off and stagnated thereafter at about the same level. A number of Japanese customers, soda ash customers, reported renewed pressure from Japanese soda ash producers. They cited that pressure as a reason why they would not increase their purchases of U.S. soda ash, regardless of the price offered. ANSAC was told that a de facto quota had been placed on U.S. sales by the Japanese producers.

In 1987, the JFTC opened a new investigation of the soda ash market. After investigation, it concluded that while the Japanese producers had not violated the Antimonopoly Law, they were engaging in certain practices which as they put it "could be problematic under some circumstances." Specifically, a practice existed under which a Japanese customer receiving an offer from a U.S. supplier first "pre-cleared" that purchase with a customer's regular Japanese supplier. In effect, they called up their regular supplier and said, "we are considering buying U.S. soda ash, what do you have to say about that."

ANSAC believes that this practice enables the Japanese soda ash producers to apply pressure to their customers to limit or refuse altogether their purchases from U.S. sources. The JFTC regarded this practice as what they called a "gray area"—neither clearly legal nor clearly illegal. They summoned in the heads of the Japanese soda ash companies and warned them to take care not to violate the Antimonopoly Law, and they indicated they would continue monitoring the market for evidence of renewed anticompetitive behavior. But they again imposed no sanctions.

Last year and this year, ANSAC sales volume in Japan has increased again. We expect this year our sales will be around about 300,000 tons, which is up from the 210,000 or so level in 1985, 1986. It is an improvement. But it is evident that a significant part of the market is still off limits to U.S. producers. While ANSAC has increased its total volume, they have not added new customers. There is evidence that total volume of U.S. sales in Japan is still being regulated by Japanese soda ash producers.

For example, ANSAC received a call at the end of 1988 from a trading company that works with Japanese soda ash producers asking to place an order for U.S. ash. They were very concerned about whether the order would count against the U.S. export totals for Japan for the year 1988 or for the year 1989. Now the question of which year the total counted against is commercially irrelevant. It has no business significance whatsoever. But it is quite relevant if somebody is trying to administer a quota. They were obviously, it appeared, trying to balance U.S. sales so that they would fit within a quota for either 1988 or 1989.

Some major Japanese soda ash customers still refuse to buy U.S. soda ash under any circumstances, regardless of price or other economic factors. The Japanese soda ash producers and the trading company affiliates own and operate the Toko Terminal, which is the only facility in Japan dedicated specifically to handling soda ash. So ANSAC has to sell its products and move its products into Japan through a facility that is owned by its direct competitors.

The U.S. Government has raised this issue with the Japanese for many years. In fact, Clyde Prestowitz was one of the prime movers in devising a U.S. strategy for soda ash. Some of the conclusions that can be drawn from our experience are:

First, that the bilateral trade imbalance is attributable to more than just macroeconomic factors. I think that is fairly obvious from what we have heard today.

Second, it is clear that more vigorous enforcement of the antitrust laws in Japan would help to open up additional market opportunities. It has for ANSAC.

Finally, it is important for U.S. industries that are seeking to penetrate the Japanese market to work closely with the U.S. Government when they encounter market barriers. ANSAC has done that for a number of years. I think the successes it has achieved to date stem in substantial part to the close relationship they have maintained with the USTR, Commerce, the Justice Department, in partially leveraging open this market.

ANSAC agrees with you, Mr. Chairman, that structural impediments to the U.S. sales in Japan are one of the most significant trade problems this country currently faces. We commend your Committee for drawing attention to this problem with these hearings and we hope that this summary of our experience has proven of some value to you in assessing an appropriate U.S. policy response.

[The prepared statement of Mr. Andrews appears in the appendix.]

Senator BAUCUS. Thank you, Mr. Howell.

Since you are a trade attorney and have some direct experience with the Japanese Fair Trade Commission, can you tell us in your judgment whether at present Japanese antitrust laws generally are sufficient, if not, you know, what basic changes should be made. Next, whether the degree to which they are enforced—that is, the antitrust laws are enforced in Japan. I will stop right there for the time being.

Mr. HOWELL. I would say that by in large, the laws are sufficient to deal with a lot of the kinds of problems that U.S. exporters face when they export to Japan. Typically like here, it is a cartel working with a network of distributors, doing things that appear to us at least to be pretty clearly illegal under Japanese law. The problem is enforcement. Soda ash is held out by the Japanese as one of the examples of vigorous enforcement of the Antimonopoly law as it affects imports.

If we are the prime example, then it is not a situation in which enforcement has been very good. Because what has happened here is, they basically found that a problem did exist, did find a cartel, but nothing was done in a way that the Justice Department, for example, would do things here—that is——

Senator BAUCUS. Why is enforcement a problem? Is it something in the nature of the Japanese judicial system or is it that there is too much discretion in the so-called executive personnel? Why is enforcement a problem?

Mr. HOWELL. They are in a weak position in Japan. Every time that they begin to take a forceful stance on these kinds of issues there is a move launched in the Keidanren to abolish them. They are regarded by many in Japan, I think, as a former MITE Minister put in——

Senator BAUCUS. You abolish them, you mean abolish the Commission?

Mr. HOWELL. The JFTC, yes. In other words, if they press too hard, I think they feel they put themselves in political jeopardy to some extent in Japan. A former MITI Minister characterized them as an alien protein grafted onto the body politic of Japan by the U.S. occupation. I think that they have to be—they feel politically that they have to be a little bit careful. You will find that, for example, they do not proceed usually against the big industries that are under MITI's wing—the big electronics sectors.

They have tried to some extent to enforce the Antimonopoly law in the steel sector and they have run into lots of difficulties there. They have had confrontations with MITI. I think they feel that there are some severe limits that are imposed on their ability to proceed against a lot of these problems.

Senator BAUCUS. If that is the case, then what should Ambassador Hills secure as part of the talks in order to know that we will achieve substantial progress in enforcing antitrust actions in Japan?

Mr. HOWELL. Well, my feeling is that we have a right to expect that they will enforce their law. It is something that I think when we entered into, for example, GATT concessions with Japan, we had a right to assume that they were going to enforce the laws that were on the books to protect the benefit of the tariff concessions we were getting when we got into a trading relationship with them in the first place.

We should ask for them to enforce their law, recognizing that perhaps there are domestic political problems there. We have a right to ask for a fair enforcement of their laws as they affect our sales in their market.

Senator BAUCUS. We have a right to ask for it, but how do we know we are getting it without waiting to see whether or not we are getting it?

Mr. HOWELL. It is pretty clear to us. There was a problem in soda ash. There probably are still problems. As those problems diminish or as they go away, it will be pretty clear to us that they have. We have a pretty clear idea of what represents success to us, at least in our sector.

Senator BAUCUS. But what statutory changes or personnel changes or budget changes or other indicators are there that we could ask for in order to better assure the chance that the Commission will be a strong, and vigorous, and in fact enforce present, existing Japanese antitrust laws?

Mr. HOWELL. It is hard to say what specific things you would ask for. One thing I would cite is just a more vigorous investigatory policy. For example, in the second JFTC investigation in 1987, they did not subpoena witnesses, they did not seize documents, they did not conduct raids, they did not wiretap, they did not do the various kinds of things that our Justice Department would normally do to investigate a problem.

When they monitor a market a lot of times what they will do, for example, is just send out questionnaires to people that are involved and say, if you have heard anything that is of interest in terms of anticompetitive acts, then we would be happy to have that.

I think my suggestion would be that they take a more vigorous investigatory posture towards some of these industries. I do not have an answer to the question in terms of whether more staff or budget is the problem. I do not really thing that is it. I think it is more a question of what they feel their job is or what they feel that their role is in Japanese society. I would say that about all we can do is really urge a more aggressive posture on them.

Senator BAUCUS. Mr. Spero, you say your company is successful in Japan, yet you talked about the patent infringement problems. First, do you believe that there are Structural Impediments in Japan, other than the patent problem?

Mr. SPERO. Oh, certainly.

Senator BAUCUS. I mean, are they very significant in your view?

Mr. SPERO. Yes. The ones that have been mentioned are ones we have experienced as well.

Senator BAUCUS. You do business in Japan. What advice do you have for this Committee as to how we can knock down some of those impediments?

Mr. SPERO. Well, I think you are taking a good step by holding these hearings. That is a very broad question.

Senator BAUCUS. Anything else come to mind?

Mr. SPERO. I think that in the broad sense, I agree with comments that have been made by other people on these panels that the Japanese recognize whether their opponents in a negotiation are dealing from strength. I think that the Super 301 and SII initiatives are both good ones but are likely to be insufficient, and perhaps we are being laughed at. I tend to agree with that observation.

So I think it is important to have these kinds of hearings and discussions between the government and the business sector to try to develop our own game plan to the point where we can come together as a nation and say to the Japanese, this is really what we intend to do—and then proceed to do it. I think a lot of our problems are internal in that sense. These activities can help address those.

Senator BAUCUS. What do we do to better assure that we are not laughed at? I suppose a lot of this depends upon the stance that Ambassador Hills and her team undertakes. That is, it is largely up to the United States negotiators to determine at this point initially whether we are laughed at or not. That is, if they are very aggressive and very far-reaching in finding solutions it is less likely we are going to be laughed at. Of course, ultimately, it is up to the Congress and more ultimately up to the American people to back up our negotiators.

Mr. SPERO. Well, I agree with that. My own personal experience with USTR, Commerce, State and other agencies of the Government is that they are taking their charge very seriously. They are attempting to do their homework. I do not think it really matters whether we are laughed at. But that is an indication of whether the Japanese are engaging in serious negotiation or stonewalling. That is really the point.

So I think that our negotiators are trying to get organized, get cases in place, get information so they can be specific and at least, at the outset, getting the Japanese to admit that there is a problem. That is, in many cases, in negotiation the most difficult point. I know in the bilateral working group on intellectual property negotiations between the United States and Japan on the patent system the Japanese refuse to admit that there is even a problem. They have been stonewalling our negotiators in discussions that began in August of 1988.

They say our Japanese patent system is just like the German system and there is no problem with that, so why don't you fix your own internal system.

Senator BAUCUS. What is the answer to that?

Mr. SPERO. The system is structured on the surface to be the same as the German system, but it does not operate that way. The disparity between what is officially written down and what actually happens in Japan is a great gulf. Other people have talked about that today. That is particularly true in the patent system.

Senator BAUCUS. You heard Senator Packwood's questions. He asked me to ask them again.

Mr. SPERO. Okay.

Senator BAUCUS. I will just ask you, what is the answer?

Mr. SPERO. He was asking about multiple claims.

Senator BAUCUS. Right.

Mr. SPERO. I think the thrust of that question was whether the existence of multiple claims in the U.S. cuts down the number of patent applications filed here and therefore we can expect more patent applications in Japan and that these large numbers are not really patent flooding. I would expect that is the thrust of his question.

Senator BAUCUS. That is right.

Mr. SPERO. My answer to that is related to my answer to his second question, which is: Does the mere measurement of the number of patents applied for indicate patent flooding?

A large number of patent applications is smoke. It does not prove that there is fire, but it sure is a good place to look. What really matters is, looking at any pattern of filing and looking at the details, what is the quality of those applications? It becomes pretty clear when you look at that, certainly in our case, that it is patent flooding and not the filing of 300 or 350 good fundamental patents. You have to look at the details.

Senator BAUCUS. Are you assured that the administration is addressing this patent infringement in the SII talks?

Mr. SPERO. Yes.

Senator BAUCUS. Sufficiently, in your judgment, at this point?

Mr. SPERO. Yes. It has been specifically included as an exclusionary business practice, which is the portion of SII which is under the jurisdiction of the USTR. I believe they are looking at that very seriously indeed.

Senator BAUCUS. Mr. Morris, could you more precisely indicate what more your industry would like in addition to the blueprint that you have heard about? If you could just be a little more definite, please.

Mr. MORRIS. Well, at the barest minimum it would seem to us that some means of blueprint by definition is fairly definite and something like a time table, something like specific monetary goals for their purchases would be most helpful indeed. But there seems to be a timidity to even ask for these things and once they are denied to us by the other side, we hear no more about them.

Moreover, it is very unsettling to find out that what is done is not all that reliable either. So there are some flaws in the reporting system now which were undertaken post-MOSS, immediately after MOSS, to where they are reporting their purchases of U.S. auto parts and to begin with allowing them to include in those numbers the purchases from their own transplant seems to me basically unfair and ought to be looked into at some length or negotiated again. Because the more they do that, obviously, the less progress is going to be made as far as any imbalance is concerned.

If ultimately they export the automobiles on which these parts are installed, of course, to Europe or anywhere else, that is going to compound the problem. But specifically, I would like to see that they—or at least that we renegotiate the ability for them to include their purchases from their transplants here in the numbers that they report on their purchases. That is just for openers.

Senator BAUCUS. What about numerical goals? The United States-Japanese semiconductor agreement had numerical targets. Some say that the agreement is unsuccessful. My view is it was only unsuccessful because it was not enforced in Japan. Do you think that there is an appropriate role for numerical targets in reaching agreements?

Mr. MORRIS. Yes, I do.

Senator BAUCUS. Mr. Howell, would you agree, first, with respect to your industry specifically and second, more generally?

Mr. HOWELL. Yes, I would say yes to both. With us, I think the way we pegged our target was, we said what do we think would happen over there if the market were open. We think that the U.S. sales would probably be about 35 percent of the total market, that there would be a restructuring of the domestic industry over there. They have some uncompetitive plants that we would have to shut down.

In an open market situation that would happen and would have happened already. We do not see any problem with setting that as a target, saying that we have achieved our objectives when something like that has happened, and supplying the numbers and telling them what we expect will happen.

I think, as a general matter, that is quite defensible. I think maybe it is the only thing that is going to produce any results in a lot of situations.

Senator BAUCUS. Mr. Spero, your reaction?

Mr. SPERO. I would imagine that numerical goals are going to be quite appropriate in some cases. But I do not think that that is as important as deciding what happens when they are not met. The problems with these negotiations is that we set the goals, and as others have mentioned, they are not enforced. That is the definition of a negotiation where the power balance is incorrect.

Senator BAUCUS. How would we enforce them? Would we resort to foreclosing American markets?

Mr. SPERO. Well, a lot of your panelists have mentioned that is the biggest asset that we have. And I believe, yes. We have to think of a way to use that constructively. People like myself who build companies and take the entrepreneurship route are free traders and we believe in not having the government tell us or anybody else what to do.

But I agree with what Mr. Pickens said. What happens if you send out a football team improperly prepared? We can have very good players, but we have to be ready. If we do not figure out a way to get the Japanese to pay attention to the fact that this very important relationship is not proceeding well, that although they may be satisfied with the ultimate outcome, we are not, and try to address that before it becomes catastrophic, I do not think we will get their attention.

So in summary, I think the issue is, what is the enforcement or backup procedure.

Senator BAUCUS. Okay. Before we wrap up, do any of you have any statements you would like to make? Somebody said something today that deserves an answer. Any of you?

[No response.]

Senator BAUCUS. Well, I want to thank you all. This has been, I think, one of the more productive hearings this Committee has had this year. We are going to have another one tomorrow.

The hearing is adjourned.

[Whereupon, the hearing was adjourned at 4:28 p.m.]

# UNITED STATES-JAPAN STRUCTURAL IMPEDIMENTS INITIATIVE (SII)

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TUESDAY, NOVEMBER 7, 1989

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
*Washington, DC.*

The hearing was convened, pursuant to recess, at 2:08 p.m., in Room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the subcommittee) presiding.

Also present: Senators Bradley, Rockefeller, Chafee, and Heinz.

## OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. The hearing will come to order.

For years Japan has told the rest of the world that Japan is different. Snow ski exporters were told that they could not export skis to Japan because Japanese snow was different. U.S. ranchers were told they could not export beef to Japan because Japanese intestines were different. The U.S. auto part exporters were told that the U.S. test data on reliability and performance could not be accepted in Japan because Japanese driving conditions were different.

I have always taken Japanese claims of uniqueness with a certain grain of salt. Sometimes they were excuses for protectionism. But now some of our most respected economists have come to the conclusion that Japan is, in fact, different. They agree that Japan is unique from the rest of the world in one important way—namely, that Japan is far more closed to imports than are other developed nations.

The President's Advisory Committee on Trade Policy and Negotiations recently issued a report that summarized the extensive evidence of Japan's uniqueness. Studies done at the Brookings Institute and the Institute for International Economics have concluded that Japan imports far less than one would expect for a developed nation.

The problem is particularly severe for manufactured imports. In 1986 imports accounted for more than 37 percent of the manufactured products consumed in Germany, 27 percent of those consumed in France and 14 percent of those consumed in the United States. But in Japan, imports accounted for only about 4.4 percent of all manufactured products consumed. Even more strikingly, over the last decade the United States has imported almost 60 percent of the manufactured exports from developing nations. Japan has imported only about 5 percent of them.

As many observers have noted, Japanese employers, a web of informal trade barriers, such as distribution barriers, price fixing and other collusive business arrangements to exclude imports. The Act then concluded that these barriers could be depriving the United States of as much as $30 billion of exports each year.

The Japanese economic planning agency, known as EPA in Japan, a Japanese Government agency, has released several interesting studies of these structural barriers. Several months ago the EPA in Japan released a study that argued that the Japanese distribution system blocked imports. Just 1 month ago, the EPA released a study indicating that U.S. exporters were not the only victim of structural barriers. The barriers also force Japanese consumers to pay 50 percent more for the same products as consumers elsewhere in the world.

These EPA findings provide strong support for the United States' view that the Japanese market is, to the detriment of Japanese consumers, largely closed to imports. The situation has improved considerably in recent months. Japan has increased its imports. But Japan still lags far behind the rest of the developed world.

Even in sectors where the United States has made great progress in opening the Japanese market, such as agriculture, informal barriers still limit exports. For example, the United States beef exports to Japan increased markedly in the year since the agreement was concluded to phase out the Japanese beef quota. But now I hear reports from Tokyo that the closed distribution system is keeping beef prices high and depriving Japanese consumers of low cost, high quality imported beef.

As the beef experience demonstrates, until Japan eliminates these structural barriers, the United States will not eliminate the trade imbalance with Japan. This is not to say that the structural barriers are the only cause of the trade imbalance. Certainly the United States bears some of the blame. But there is no denying that Japanese structural barriers are blocking U.S. exports to Japan and forcing Japanese consumers to accept a lower living standard.

With this in mind, the U.S. Government recently launched the Structural Impediments Initiative, known as SII. It was conceived as a broad effort to eliminate Japanese structural barriers. I strongly support the thrust of SII and have argued for several years that the administration should launch a broad negotiation with Japan.

This subcommittee has already held two hearings on the SII. Those hearings demonstrated broad consensus in the government and the private sector that the Japanese structural barriers must be eliminated.

The purpose of today's subcommittee hearing is to further explore the U.S. strategy for addressing this trade problem with Japan. I am pleased that a number of representatives of the academic community have joined us to discuss the Japanese trade problem and outline their proposed solutions.

Today's witnesses have some exciting, innovative ideas regarding the U.S. objectives in the SII and U.S. trade policy toward Japan.

The debate over U.S. trade policy over Japan increasingly centers on the issue of what type of trade agreement the United States should negotiate with Japan. Many argue that we can no longer negotiate agreements that focus only on establishing fair trading rules. Instead, they say we must begin to conclude agreements that guarantee results.

As several observers have pointed out, this issue bears a striking similarity to debate over using affirmative action to remedy racial discrimination in this country. Given that discrimination against imports has been such a persistent problem in Japan, does affirmative action for imports make sense? If in limited sectors where U.S. exports have been blocked by invisible trade barriers, and where all else has failed, I believe that it does.

But embarking on such a course is not without risk. Today's discussion will shed some light on these very complex issues as well as many others. I hope that the administration takes note of the concepts discussed today and incorporates them into the SII. I also hope that our Japanese friends take note of the wide consensus in the U.S. academic community, that there is a serious United States-Japan trade problem.

With that, let's begin our first panel which consists of Dr. Dornbusch, who is Ford International Professor of Economics at MIT; Mr. Ernest Preeg, who is a William M. Scholl Chair in International Business, Center for Strategic and International Relations; Mr. Robert Lawrence, a Senior Fellow at Brookings; and Pat Choate, Office of Policy Analysis at TRW. Could all four of you come up here?

Okay, Dr. Dornbusch, why don't you begin? I understand you have a potential early departure.

## STATEMENT OF RUDIGER DORNBUSCH, PH.D., FORD INTERNATIONAL PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CAMBRIDGE, MA

Dr. DORNBUSCH. Not only potential, but I hope very real. Thank you, Mr. Chairman.

I appreciate the opportunity to express to this Committee my opinion on U.S. Structural Impediments Initiatives and U.S. trade policy toward Japan. More generally, I believe the Structural Impediments Initiative is yet another unfortunate and unproductive way of dealing with our large trade balance deficit and the continued closeness of the Japanese market is unlikely to have results and it is very likely. In fact, it has already created major friction.

The U.S. agenda includes such issues as Japanese land use, business practices, antitrust—all of which have little to do with our trade deficit. The Japanese agenda includes the U.S. budget deficit, the short horizon of U.S. business, the lack of education, training and productivity—all of which have much to do with our deficit. I believe that if we enter the negotiations, if the Japanese agenda comes off, our deficits will go away. On our own, it is very unlikely that the negotiators will have any impact.

I believe it would be a useful thing if our negotiators sharply separated the trade balance issue from the market access issue. Failing to make that distinction lays us open rightly to the charge that our trade problems are a reflection of our macroeconomic problems and as a result we never get to discuss the serious issue of market access in Japan, which is a rightful concern for us.

I favor a hard-nosed approach to the market access issue and, of course, with urgent priority a serious domestic policy of budget correction and savings. I want to argue very strongly against the use of bilateral trade balance concepts that underlie the current negotiation strategy. That is an unfortunate concept that Congressman Gephardt has injected into the discussion.

It is worth remembering that it was invented in Hitler Germany that it was the guiding principle for a long time in Soviet COMECON. But that even there, they had to give up on it. I think for a free market economy it is a totally absurd concept. It borders on barter.

Even the trade balance approach to market access in Japan is inappropriate because the trade balance reflects saving and investment. Our saving is low relative to our investment and, therefore, we have a deficit. It is very hard to see how improved market access in Japan would lower U.S. investment, something that is certainly highly undesirable or how it would contribute to our increased saving. One can imagine, yes, if U.S. firms could sell more in Japan, made more profits, saved all those profits and paid more in taxes, we would have an improved trade balance. But that is a very indirect channel.

In fact, today, we cannot afford an improvement in the trade balance. The U.S. economy is fully employed and if we could sell an extra $50 billion more in Japan our unemployment rate would go into the red hot zone of overheating. We would have increases in inflation, very substantial ones, higher interest rates, falling investment and certainly dollar appreciation that would hurt other exports.

I want to direct your attention to the fact that our trade problem, above all, is an issue of U.S. fiscal correction and saving, not of market access in Japan. But having said that, I do want to come to the issue in these hearings—namely, what to do about the closedness of the Japanese market.

I think there is today very, very little difference of opinion among those who have looked at the Japanese market, about the fact that it is closed. Pieces of evidence only differ. My favorite one is the ratio of imports of manufacturers to GNP in Japan, a constant of 2.5 percent for 25 years. In every other country that ratio has doubled or tripled.

The common argument is that Japan is a resource poor country and therefore has to export manufactures and will not import is a fallacy. Japan could export even more to pay for some imports of manufactures. And so is the argument that the share of imports in manufacturers has sharply risen. That is a reflection of the fact that oil prices have fallen to half, not of sharply higher imports in Japan.

An appropriate trade response toward Japan should not look not at the mechanisms of how our goods are kept out or at sectors, but rather set targets across the board, putting on Japan the burden of adjustment. My favorite policy would be to require that Japan increase its imports of U.S. value added at the rate of 15 percent per year for a decade and if that target is not met, there would be an automatic across-the-board tariff surcharge on Japanese exports to the U.S. market.

That would give Japan an incentive to act. It would depoliticize and certainly in the silly way it is done, the negotiations that are underway now.

Thank you very much.

[The prepared testimony of Dr. Dornbusch appears in the appendix.]

Senator BAUCUS. Thank you very much, Doctor.

Dr. Preeg.

## STATEMENT OF ERNEST H. PREEG, PH.D., WILLIAM M. SCHOLL CHAIR IN INTERNATIONAL BUSINESS, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES, WASHINGTON, DC

Dr. PREEG. Thank you. I am also very pleased to be here today to discuss the structural impediments initiative.

I certainly believe that the SII should play a central role in bilateral negotiations over the coming year and does have potential. However, thus far the talks are lacking in credibility and I think we face a real problem if next spring and summer, as our trade balance is projected to worsen, that we come to a result that is not credible or does not deal with the problem at hand.

Therefore, we need to think of ways to strengthen the SII process and to make sure we do make some very substantial progress. I am suggesting four steps that could move in that direction.

The first is that we need an integrated strategy for the overall United States-Japan economic relationship. We just do not have one. It has to combine the macroeconomic policy adjustment that Dr. Dornbusch was just alluding to and the market access issues. It has to relate bilateral objectives with what we do in various multilateral forums and it has to have a longer term vision of where we are going in this evolving relationship.

Second, I think we do, even within the SII, have to distinguish between the macro policy adjustment and the market access objectives and have a distinctive strategy for each. The macro issues, or at least some of them, are on the agenda and what we need to do is to have a bilateral focus on the adjustment process because we are the two major countries out of balance, so that we can then move to the G–7 or the more appropriate financial Minister forum to really move ahead on an adjustment process.

That could involve targets or objectives, but I would submit that they should be multilateral on current account, rather than bilateral trade targets.

A third step we could take would be to link the SII bilateral objectives more specifically and more forcefully to parallel reinforcing objectives in various multilateral forums.

In the prepared statement I have some specific suggestions in terms of land use, in terms of access for foreign direct investment, in terms of the engineering construction services industry. The Japanese do have commitments in the OECD, in the GATT. We should be pursuing them there forcefully and that could have an overall more positive result if we are moving on both tracks at the same time.

And lastly, fourthly, we need to specify objectives in the SII, both in terms of market access and quantifiable results. In my view it is a false dichotomy to say you have to do one or the other. Between now and next spring, or next summer, we need to have some specific objectives in terms of market access, particularly on the Japanese side, of course. But we then need some kind of monitoring mechanism to see just what the results are, in close consultation with our private sector to see whether, in fact, commitments undertaken by the government of Japan are in fact being carried through.

These are the four steps that I suggest could strengthen the process of SII. It is based on the assumption that there is a process of change underway in Japanese society toward a more open and competitive economic system.

The structure and the workings of the Japanese economy are very different today from ours. But I do not agree with those that believe that the differences are so fundamental and so immutable that we have to jettison our longstanding market-oriented approach to trade policy towards some kind of a bilateralism and targets.

Which brings me to my final point, Mr. Chairman. That is about the alternative to the SII approach, enhanced as I would suggest, but an approach based on opening markets and forcefully pursuing these objectives. Some criticize the SII as inadequate and advocate what can appear to be simpler and more effective—namely, the negotiation of bilateral trade targets by sector or for aggregate trade.

Unfortunately, this is not going to work to the U.S. advantage. It is going to lead to pervasive trade restrictions such as the existing voluntary export restraints on automobiles and import floor prices for semiconductors. This just makes our industry less competitive and it gives greater profits to the Japanese industry, as in the two cases that I mentioned, that they can reinvest to become even more competitive.

Bilateral import restrictions, or even the threat thereof, are also pushing Japan and its Asian trading partners closer together toward a potential inward directed regional block, while undermining the GATT multilateral trading system. In sum, while the SII can be painstaking and slow to produce concrete results, it should work in the right direction of a more open competitive trading relationship. And to change that policy course would weaken U.S. international competitiveness at a time when it has become vital to our economic future and for our future national security.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Preeg appears in the appendix.]

Senator BAUCUS. Thank you, Dr. Preeg.

Our next, Dr. Lawrence.

## STATEMENT OF ROBERT ZEE LAWRENCE, PH.D., SENIOR FELLOW, BROOKINGS INSTITUTION, WASHINGTON, DC

Dr. LAWRENCE. Thank you very much, Mr. Chairman. My testimony makes four major points and I would like to deal briefly with each of those.

Firstly, I believe that there is a need for this SII initiative. I think it is supported by the evidence, which is very considerable, that the Japanese market is unusually closed. You cited some of the studies. Professor Dornbusch gave some evidence. I would like to cite my indicator, which I think is the most important evidence—that is, simply the behavior of prices. Prices of goods, internationally traded products, are 30 or 40 percent higher in Japan than they are in other parts of the world. It simply must be true that given these large differentials, something prevents people from buying where the prices are low and selling where the prices are high.

That is the most important evidence, I think, about the closed nature of that market. It is bolstered, however, by evidence on the structure of Japanese trade. The low share of manufactured imports, the low amount of intra-industry trade that characterizes the Japanese trade and as well, the very high share of shipments indeed of U.S. exports that are actually undertaken by Japanese firms located in the United States.

Japan is unusual because its trade not only have a low amount of intra-industry trade, but it also have an unusually high amount of intra-firm trade indicating, in my judgment, that there are unusual incentives in the Japanese marketplace that strengthen domestic monopolies and give the Japanese advantages as buyers of products for that Japanese marketplace.

Secondly, I think it is important to be clear, as Professor Dornbusch underscored, that the SII should focus on achieving a more open market and not a lower trade deficit. If we confuse those two objectives, then I think our policies will be muddied, appraising the success or failure of those policies will be extremely difficult. It may well be true that the trade deficit comes down, but we make no headway in seeing that marketplace become open.

I think it is very important to keep those two arguments separate and I agree with him that the primary concern of the detailed structural discussions should be about the openness of that marketplace. And we should judge that by the behavior of prices in Japan and the behavior of exports and sales in Japan. We should not confuse that question with the aggregate trade deficit one, which is a question of savings and investment.

Third, my testimony expresses some concern about the initiative. First, while I think we are clear about our goals and what we mean by an open market, I am not so sure that we have prior agreement from the Japanese that they are committed to the same goal. I would prefer to proceed initially with an agreement on that goal.

Indeed, I think we should take a leaf out of the European book, that we should sit down with the Japanese and come with a vision of the kind of market, a single market you can call it, that we would like to see between our two countries at some point in the future, maybe in the year 2010. We should then establish how we get from here to there and then, and only then, proceed to sit down and discuss the details. I really worry that we have a different ultimate objective in mind than they do and it is critical to clear that up before we get into the details.

Second, I think we should make sure that we not turn this discussion into a super impatient initiative. We are talking about detailed structural aspects of one another's economies. These are deep questions. They will certainly not be resolved by next March or April. We need commitments to proceed in these areas. I think it is worth proceeding to discuss the detailed differences. I think we may have to support these talks by detailed discussions sector by sector as well.

I do support this initiative therefore, but I am not sure that we should expect that we will get dramatic changes overnight.

Now there is a major question and I think members of this panel clearly differ on it. That is, whether we should continue to emphasize the issue of rules of behavior or whether we should move in a much more explicit fashion to aggregate, quantitative targets.

I personally believe that that would be an error. I believe it would be an error because it could be counter productive in terms of our ultimate goal, which is a genuinely open and contestable market. I also believe there are significant signs that although the significant barriers are present, the Japanese economy has been changing—too slowly from our standpoint.

I would cite just one piece of information—the fact that the volume of manufactured goods has doubled between 1985 and 1989. So I do see signs that there are changes going on in Japan. I see signs that our earlier strategies are working—working too slowly perhaps. But nonetheless, I think it would be inappropriate for us to change our tune, to deviate from a strategy which has emphasized contestable markets and to shift towards a strategy which would simply seek to quantify the results no matter how they were achieved.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Lawrence appears in the appendix.]

Senator BAUCUS. Thank you very much, Dr. Lawrence.

The final panelist is Dr. Choate. Dr. Choate.

## STATEMENT OF PAT CHOATE, PH.D., VICE PRESIDENT, OFFICE OF POLICY ANALYSIS, TRW INC., ARLINGTON, VA

Dr. CHOATE. Mr. Chairman, Senator Rockefeller, I would like to speak as an advocate of impatience this afternoon.

It seems to me that the most striking feature of American trade negotiations with Japan is their share predictability. By now we know in advance, not only which issues will be discussed, but we also know the approaches that will be taken by both sides and we know that the results will be achieved.

Let me give you an example. In August 1972 President Nixon met with Prime Minister Tanaka in Honolulu. The primary subject of their summit was the expanding American trade deficit with Japan, which that year had reached an extraordinary level of $3.8

billion. In response to the deficit problem, President Nixon called on the Japanese to do a number of things.

First, he urged them to reduce their nontariff trade barriers. Then he asked the Japanese to buy more American-made computers. Other U.S. negotiators pressed the Japanese to buy American-made aircraft and satellites. President Nixon requested that the Japanese purchase more American agricultural products. He said the Japanese should eliminate barriers to the establishment of purchases of retail outlets in Japan by U.S. companies and he called on the Japanese to liberalize their business distribution system.

At the close of the conference, in the closing communique, President Nixon—and if I will quote—"The President also noted with appreciation the recent decisions by the Government of Japan to liberalize access to the distribution system by allowing improved investment opportunities in retailing, processing, and packaging as well as the decision to allow greater sales of computer products in Japan."

In the end, both President Nixon and Prime Minister Tanaka affirmed their support for the GATT negotiations. On October 19, 1989, U.S. Trade Representative Carla Hills addressed the Japan National Press Club in Tokyo. Ambassador Hills' main concern was the massive United States-Japan trade deficit, which at this point hit $50 billion. Her comments last month, while certainly timely, are also hauntingly familiar.

Like President Nixon nearly 20 years before her, Ambassador Hills encouraged the Japanese to reduce their nontariff barriers. She called on them to lower barriers to the sales of U.S. satellites and supercomputers. She urged the Japanese to buy more American forest and agricultural products. She told the story of how the Japanese Government is keeping two of America's largest retailers—Toys-R-Us and McDonald's—from opening stores in Japan for 2 years while it deliberates on the firms' investment applications. And finally, she asserted that Japan's closed distribution system hurts American exporters and Japanese consumers and urged that that distribution system be liberalized.

In the end, like President Nixon, she also reaffirmed this nation's commitment to another round of GATT negotiations. It seems to me that what the Hills-Nixon example suggests is that America seems to have a passion for process-oriented negotiations rather than results.

In this testimony I identify seven other market opening measures that we have negotiated with the Japanese over the past decade, plus two other major measures, including the MOSS negotiations and there have been additional. It seems to me that we are really at a point which we must recognize that we end the decade of the 1980's, that is, after all these market opening processes and all of these negotiations, the Japanese market remains only marginally more open than it was at the end of the 1990's.

Indeed, Taylor Rand's observation about the bourbon seems appropriate to us. That is, they forgot nothing; they learned nothing.

Now it seems to me that the one clear lesson of U.S. bilateral trade negotiations of the past decades is, is that if it processes what you want, process is what you will get. What we need are results.

In the final analysis, it seems to me that the difficulty lies not with Japan, but with we here in America. American trade policy remains locked in the past. The obvious flaw in our thinking is that Japan's economy is like ours. It is not, nor will it be, nor should it be. And what's more, they keep telling us so and we keep refusing to believe them.

Indeed, Japan operates in the world using a very different set of assumptions. It operates using a very different end objectives and our nations differ in many ways. Different is not better or worse. Different is simply different.

What it suggests to me is that we have got to come to the point where we recognize that Japan is unlikely to abandon its economic system which serves its interests so well and adopt an approach that serves ours well instead. It seems also to me, is that we are clearly at a point where we need a bottom line approach in which we negotiate with the Japanese on outcomes, time tables and mutual responsibilities. We require agreement on levels of permissible trade imbalances, the composition of trade, allowable market shares, investment and practices like dumping in third markets.

My comment in sum, therefore, is this: I suggest that while the intentions of SII are laudable, its prospects for reducing the trade imbalance are negligible at best. I fear that once again we will get much process and few exports. In sum, it seems to me appropriate for us to begin to devise a blueprint for a bottom line approach to negotiations with Japan. I fear that we will need it next year when SII is completed.

[The prepared statement of Dr. Choate appears in the appendix.]

Senator BAUCUS. Thank you, gentlemen.

I would like to begin first by asking you, what leverage do you think the United States has to reach a successful conclusion here? There are those that say that the leverage we have is our market and there are others who say that perhaps we are losing that leverage as the world changes.

So I am just going to ask the panelists your recommendations as to what leverage we have to try to reach more market access in Japan.

Dr. Dornbusch.

Dr. DORNBUSCH. I certainly believe that for conscious result oriented trade policy we have very substantial leverage. This is a large market. Japan has to play in the world market. They cannot afford to get their own way now. But the SII will be totally unsuccessful because we do not use leverage. There will be without doubt a declaration that success was achieved, that there is a long-term time table, that these are important structural changes and there will be a few more supermarkets in Tokyo without any consequence to our exports. We are not using any leverage; we are just making noise.

Senator BAUCUS. Again, the leverage is what, the U.S. market in your view?

Dr. DORNBUSCH. The U.S. market, the U.S. security umbrella for Japan.

Senator BAUCUS. You are saying we should be prepared to use those?

Dr. **Dornbusch**. We certainly should. If we do not use them now we will regret it later.

Senator **Baucus**. Okay.

Dr. Preeg.

Dr. **Preeg**. Well, I agree. It is the leverage of the U.S. market, for exports. I also think more and more it is their direct investment in this country. It is very important to Japanese companies. But they also have markets elsewhere—in Europe certainly—and we should, as I said earlier, be concerting more with other trading partners to put the pressure on the Japanese.

I also think that the SII—one other point—should be as much a public as well as a private effort of diplomacy in that I think there is a change. It may be very slow and gradual, but Japanese consumers and Japanese in various walks of life are realizing that there are gainers and losers within the Japanese society. We could play to that as well.

As for the ultimate leverage, I think there is not an easy answer, because putting trade restrictions on is not going to necessarily help us, even though it could hurt them. I think the ultimate leverage should be much more in the macroeconomic adjustment. That ultimately, if trade does not get more into balance we are either going to have exchange rate adjustments or we are going to have a major recession in all countries—in the United States in particular.

Senator **Baucus**. Dr. Lawrence , what is our leverage?

Dr. **Lawrence**. Well, I think we have sticks and carrots. I think on the stick side—because there is a presumption that somehow we are forcing Japan to do something that is very bad for them. I happen to believe that we are urging them to do something that is mutually beneficial. So we do have some sticks. Clearly, ultimately, if there is not headway, who knows what will come out of the Congress and elsewhere—alternatives which the Japanese simply won't find acceptable, I think, unless there is progress that is going to occur. I think every day we get closer to a sense of frustration building up in the United States where that could come about.

But I think I would like to emphasize, these initiatives will only operate effectively to the degree that the Japanese are convinced that they are worthwhile doing. When I look at Japan today, I do see that there are important sectors of the Japanese economy that find what we are urging them to do in their own economic interest. I think the Economic Planning Agency and MITI—I think the Free Trade Commission of Japan all will benefit as a result of this SII.

I think that foreign pressure is critical in strengthening the hands of those Japanese who are asking themselves the question: Why is it, if they are basically as productive as the United States is in manufacturing, they only have 70 percent of our living standards. It is clear that that system is not delivering the consumption and living standards levels that it ought to be.

So I think working on the carrot side in obtaining support from indigenous Japanese elements is critical too.

Senator **Baucus**. Thank you.

Dr. Choate.

Dr. **Choate**. I think our only lever is our market access. I think in approach it we must, in our negotiations, say that we are attempting to do what is best in our national interest. I presume right off the bat that the Japanese are quite competent to define what is in their own best interest.

I think it also important for us to recognize that once we are willing to use market access as a means of opening that market, then we have many levers. But because of the depth of this trade deficit today, I think it is also imperative to realize, is that any adjustment in practices between our two countries is going to necessarily involve a degree of pain here in the United States. I think it is unavoidable. The only consolation we can have, it will be less painful now rather than later.

Senator BAUCUS. Thank you.

Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

I guess I would direct this at Dr. Lawrence. We discussed this somewhat yesterday, and the question is how one gets to the Japanese in terms of getting them to make changes which are clearly not in their interest unless they see that it really is in their interest because of some action we might take. In a sense, it is ironic because the large size of our market has been our greatest barrier to overcoming our own lack of skills at exporting. But it is a tool, the ultimate tool.

Now you can criticize the Semiconductor Agreement, which has generated a lot of heat in Japan, but it has worked basically. It started off slowly, but it has basically worked. You may disagree, but it has worked more than anything else has.

My question is two-fold. There is no way you can talk about using the leverage of our market without talking about putting up barriers which turns into protectionism and there is no way to clothe that in fine gowns; and we do not want to do that. But in a sense you are all saying we have to.

And then there is a second question. That is, we talked yesterday about polls and the Japanese young people who are very upset with us. We are very upset with them. Rising tension. Two great countries with enormous bilateral interests that coincide, in fact, and yet on the issue of trade and openness we both engender terrible feelings. The question is: Do you think that we are in a period where bad feelings are inevitable and necessary to the creation of a new, but realistic, relationship and that, therefore, we should not worry about a temporary bad relationship—a lot of flack going back and forth across the ocean and genuinely bad feelings—because we are not, in fact, going to give up the cultural relationship, the business relationships, the security relationships?

That is, we really shouldn't worry even as our bilateral relationships appears to be substantially weakening. There is no other way we can get to a more realistic relationship. You understand what I am saying.

Dr. LAWRENCE. Well, on the first point—on using the market—quite frankly I don't think we use, when we do use our market, I do not think we use it in the right way at all. If you look at the semiconductor agreement, what we do with Japan is we ask them, please, to kindly voluntarily restrain their exports to us, but we do not mind what price they charge.

So what happens is, they restrict the quantity and they rip us off on the price. That is the story with steel quotas. That is the story with auto quotas. That is the story with semiconductors. If we really are going to use our market as an effective tool, I think actually we should have followed our own trade laws, the letter of those or the spirit of those, and when we find that there is dumping in our market, when we find there is selling below cost, when we want to use our market for any purpose at all, it is tariffs. We have to use tariffs, not quotas, when we use our market. Let me just state that.

The second point is, I think you make a very good point about the bad feelings and the frictions. If you are getting into serious negotiations there are going to be winners and losers. There is no way you are going to overcome these frictions. I think that the search for a quick and easy fix, be it a free trade area or some magic number for the trade deficit, some way of avoiding getting into the nitty-gritty of the structural problems sector by sector is an illusion.

I think there is no alternatives but to get down and to talk substance sector by sector. I know it is painful. I personally believe that in numerous instances you can see that it has begun to show results. I think if you look at the MOSS talks, the evidence in that ACTEN Report indicates that our exports in the MOSS sectors were twice as rapid as our exports generally. If you look at tobacco, if you look at other areas, I think you have seen that in fact there has been success.

So I would advocate looking at the details and I would not try to avoid friction at all. I think friction is going to be inevitable and, indeed, it is likely to grow. The more meaningful the results are, and the greater the potential the results from the negotiations.

Senator ROCKEFELLER. Pat.

Dr. CHOATE. Well, I would have two comments, basically. The first is is the way we have conducted trade policy in the past should not be considered the standard on how we should conduct trade policy in the future. I would note that in this process of adjustment that is going to happen, in some way I think we have to recognize that we have had a relationship that is essentially unequal and nonreciprocal. And in developing a much more mature relationship with the Japanese in modernizing this relationship, we must simply assume that there are going to be frictions and that there is going to be paid and there is, in effect, going to be a lot of bullying of both sides as this goes forward in time.

But it is essential that we establish the equal and reciprocal relationships. And the challenge is to do it sooner rather than later.

Senator ROCKEFELLER. My time has passed. Senator Chafee, do you have opening comments or questions?

Senator CHAFEE. I just have a couple of questions if I might, Mr. Chairman. Thank you.

It seems to me that if the Japanese are saving more than we are and if they are out producing us or building a better mouse trap, that is fine. That is life. I have not supported the steel quotas or the VRA's as far as the automobiles go and so forth.

But what do you say about conditions that are truly restrictive in their markets to the entry of U.S. goods where U.S. goods are clearly competitive or even superior. For example, when you talk with our major engineering firms and building construction companies, it annoys them considerably that the Japanese construction companies are building some public works in this country—coming in, bidding, getting the jobs, and building them.

Yet, somebody like Fluor, or whoever it might be, Bechtel, goes to Japan and seeks to bid: first they have to be licensed to bid and then there are all kinds of obstacles put into their bidding. Now what do we say to that? Do we just accept that as one of these difficulties that we have with an ally? What do we do? Dr. Choate.

Dr. CHOATE. I think that what we should do is find ways to retaliate. What we must demand is reciprocity and in doing that what we in fact must say, that there is a very real difference between closing the U.S. market as a means to open another market and closing the U.S. market for sure protectionism. The first will expand trade ultimately; the latter will contract trade.

I think the other thing that we have to——

Senator CHAFEE. Well, isn't that what Super 301 is all about?

Dr. CHOATE. Yes. You know, I think that Super 301 is very appropriate in that. It should be very hardly administered. But when one takes a look, for example, in other societies when one takes a look for example inside Japan is what one suddenly sees is a power structure that is set up in a triad, where on one side of the power structure you will have the bureaucrats who control the agencies, you have the Japanese diet which have a major hand in controlling the bureaucrat, and then you have business interests that provide the money into the LDP and, in effect, putting in something in the neighborhood of 15 billion yen per election cycle. And so suddenly what you have is a system that is balanced off in paralysis and simply cannot react unless it has outside pressure upon it.

And so it brings us back to the point that the only way that we will be able to get our firms into those markets is to bring that outside pressure and apply it firmly, fairly, consistently, and if need be, for the long term.

Senator CHAFEE. Okay. Now, what do you say? I cannot read the name there.

Dr. DORNBUSCH. Dr. Dornbusch.

Senator CHAFEE. Dr. Dornbusch, yes.

Dr. DORNBUSCH. I would like to say that we certainly should use the access to the U.S. market as the stick, but it could really be a big mistake to get into arguments about the Japanese on every single item that is restricted because we have no idea how our goods are kept out.

If General Douglas MacArthur did not get it right, now it is too late. We should phrase our policy by saying, this is the growth rate of U.S. value to be shipped to Japan and if you do not want it, then we have a tariff. And you can arrange for the shipment. Your firms can, anyone can. We do not care what it is, but this is the growth rate.

The current strategy of saying we really do not like how you use the land in downtown Tokyo, you ought to have more supermarkets, and we want an amendment to your antitrust laws, we would not accept here; they cannot possibly accept there. It is not going to happen and it just is totally counterproductive.

Senator CHAFEE. Well, I do not think anybody argues with that. I must say, it seems to me it is rather odd, us lecturing the Japanese that they must spend more on their infrastructure. That is a cavalier attitude, it seems to me, for us to be telling them to do that.

Dr. Dornbusch seemed to be saying that if the trade is considerably imbalanced we should lecture them in that point. But it seems to me you have to take the specific items. If we build a better satellite or computer or whatever it might be, then we have a legitimate case. But I do not see how we can just go around complaining that they are selling us more than we are selling to them.

I notice that we do not complain that Australia buys more from us than we do from them. That is not a grounds for complaint. So how can it work the other way around. Do you agree with that, Dr. Lawrence?

Dr. LAWRENCE. Yes, I agree with you, Senator. You see, it may satisfy some people to turn around to the Japanese and to say, look, you just have to import a certain volume of goods and you can decide what they are. But I wonder if it turned out that the Japanese decided that the firms who imported those goods into Japan were not American firms, not even foreign firms, but rather the foreign affiliates of Japanese firms, would we really be happy? Would we really find, even if mechanically the trade deficit turned around, we were in a situation that we would find satisfactory?

Now I think it would be better for American workers and workers employed by those Japanese. That is true. But I do not think we would look at a Japan that was meeting those aggregate import numbers, but through imports from Japanese subsidiaries around the world and find that a satisfactory Japan.

I also do not think Japanese consumers would find that a satisfactory Japan because they would realize that their trade was still being controlled by these few companies, that prices of the products in Japan were still being controlled. So I do not really see that by moving to say, you know, there is a simple solution with a few numbers that we are going to impose on the Japanese, we are really going to achieve the kind of contestable open markets that are in the long run benefit of American exporters and Japanese consumers.

That is the ultimate objective.

Senator CHAFEE. My time is up here. So a quick question, does everybody approve of Super 301? Dr. Preeg.

Dr. PREEG. Well, Super 301——

Senator CHAFEE. Yes or no.

Dr. PREEG. As an ultimate weapon, yes.

Senator CHAFEE. All right. Thank you.

Senator BAUCUS. Senator Heinz.

Senator HEINZ. Mr. Chairman, thank you. I do have a question for Dr. Preeg. Dr. Preeg, I understood you to say that you agreed that the relationship with Japan is unequal and nonreciprocal currently. Would you agree with that?

Dr. PREEG. I would agree particularly in certain high tech sectors in terms of access to market. There is no question that U.S. firms do not have the kind of access that Japanese firms have here in this country.

Senator **Heinz**. But you and Dr. Dornbusch would disagree with the method of doing something about it; is that right?

Dr. **Preeg**. I would say yes in a couple of respects. First—it has come up once or twice—but I certainly would like to reiterate that there is a distinction between adjusting the huge unsustainable overall imbalance in our trade bilaterally or multilaterally. That has to be mainly macro-policy adjustment. We have our part to do in restraining consumption, getting more of our resources into exports, et cetera. That is going to be the bulk of the answer to getting our trade back in balance.

The other distinct objective, although it is supported to an extent, is going after specific industry, specific practices in Japan that keep our firms from having equal access, either exporting or investing. I think the engineering construction sector that was just mentioned by Senator Chafee is an ideal example of where we need to press Japan at every step and in every way to make sure our companies do get improved and ultimately equal access.

Now that will help our trade balance to some extent. But it is a more qualitative and targeted approach and it is not by any means the overall solution to the trade imbalance.

Senator **Heinz**. When you say macro-policy adjustment, I assume what you mean is, the dollar should go a lot lower.

Dr. **Preeg**. It probably should, in my view, although it is very hard to project. The first thing we have to make sure is that our own economy can restrain consumption enough so we have that $100 billion or $150 billion of resources to shift into exports. Then we have to have the mechanisms or the incentives to push them into exports. That can affect interest rates and exchange rates also.

Senator **Heinz**. There is a lot of evidence—and I will not take the time of the Committee to quote it, I am sure you are familiar with it—that shows that when the dollar did get down to 120 yen and stayed there for quite awhile, and where the dollar was much weaker in other currencies, we had a real export surge, even to the debt burdened LDC's. We had an export surge to the EC.

But with respect to Japan, very little happened. Very little happened. Our experience has been echoed many times over by many of Japan's neighbors, such as Korea, who also have a very difficult time doing business in Japan. Do you have a comment on that, Dr. Preeg?

Dr. **Preeg**. Very briefly because I think Dr. Lawrence probably, if he might, would have more to say. The imbalance remains. In certain areas we have restrained. I mean we have made some in roads. But the bilateral trade balance certainly has not gone done comparably with Japan as with the rest of the world.

Dr. **Lawrence**. Senator, I think one has to distinguish between the overall trade deficit and what has happened to our exports as a result of the exchange rate change. It is true, the overall trade deficit with Japan has come down only slightly—from about $52 billion to now about $45 billion in the recent numbers.

However, if we look at what happened in the Japanese market place, it is simply untrue to say that our exports did not surge. The volume of manufactured exports into Japan in the first quarter of 1989 was 100 percent higher than it was 4 years earlier in 1985.

Senator **Heinz**. Low base.

Dr. **Lawrence**. That is true. But the issue here is: Is the market sensitive to exchange rate changes? Do the Japanese respond at the margin——

Senator **Heinz**. No, that is not the issue. That is not the issue.

Dr. **Lawrence**. Well, I believe——

Senator **Heinz**. No, no. To you that is the issue. To Dr. Preeg the issue is: Can macroeconomic forces redress the unequal balance of trade? That is the question. That is the issue. We are not asking the question: Are exchange rates irrelevant? Of course, they are not irrelevant. The question is: Do they have enough power, given the structure of the Japanese economy?

I see Dr. Choate has a comment he would like to make.

Dr. **Choate**. Yes, I do. I think that in dealing with the Japanese economy that it is necessary to look at it in a rather classic sense as one would in political economy and focusing increasingly on the political side of it rather than the classic macroeconomic side of it. Macroeconomics can go so far. But beyond that what we are dealing with are the political dimensions of economics.

That ultimately is what is going to determine it. Because what we have is a political structural that emphasizes cartels and a different form of organizational structure in a society that has a different set of objectives that is essentially focused on global market shares. And unless we deal with the political dimensions of the issue, we can play with the macroeconomics all we wish and we will have no results as we have seen over the past 5 years.

Senator **Heinz**. As I interpreted your remarks, over the past 17 years.

Dr. **Choate**. I would even go maybe in the past 40 years.

Senator **Heinz**. My time has expired.

Senator **Baucus**. Thank you, Senator.

Senator Bradley.

Senator **Bradley**. Thank you very much. Mr. Chairman, let me pose the question not in terms of protection or free trade because those are highly charged words, but in terms of unilateralism versus multilateralism.

I would like to know if a bilateral imbalance with a country is something that people should be concerned about if the multilateral balance is not alarming? Dr. Preeg?

Dr. **Preeg**. No. Clearly the multilateral balance is what counts. I would say it is not just the trade balance, but the broader current account balance. The target should be multilateral balance and that would be a combination of surpluses and deficits on various bilateral accounts.

Senator **Bradley**. Dr. Lawrence.

Dr. **Lawrence**. I would agree with that. Indeed, if you start to set targets for bilateral trade imbalances you are going to lead Japan to distort its trading patterns in a way that severely threatens the multilateral trading system.

Senator **Bradley**. Dr. Choate.

Dr. **Choate**. In principle I agree with that.

Senator **Bradley**. Which is a better indicator of trade barriers?

Dr. **Lawrence**. I would suggest that neither tells you anything about trade barriers. If you look at West Germany, which I think, with the exception of its telecommunications market, people would say that is a very open market. That economy has a gigantic trade surplus, one that is twice the ratio of GNP than Japan does. Therefore, it runs huge bilateral trade surpluses with its European trading partners.

And we know, although there are some barriers there, it is a very open market. So it does not tell you anything. In my judgment, the kind of evidence you have to look at are things like price behavior. Look at what happens to prices in Japan for the same products and compare that to prices elsewhere around the world. If those prices behave very differently then there is a prima facie case to say that something is preventing people from buying where it is cheap and selling where it is high.

So I do not think that bilateral balances tell you anything about barriers. They tell you—multilateral balances tell you a lot more about saving and investment behavior.

Senator **Bradley**. Could each of you tell me what you think is the connection between the U.S. budget deficit and the U.S. trade deficit?

Dr. **Preeg**. There is a connection in that until we reduce our overall consumption so that we can free up the resources to shift into net exports, we are not going to be able to reduce our trade imbalance. That was a problem in late 1988, early 1989. We were making progress in reducing our trade deficit but then we ran up against a full employment situation. There were no resources to switch. And certainly the public sector bears a good part of the blame, I would say, the major burden at this stage, to bring its accounts back into balance. This is certainly a prerequisite to really bringing our trade deficit down substantially.

Senator **Bradley**. Dr. Lawrence.

Dr. **Lawrence**. I think historically the emergence of a large fiscal deficit and the associated decline in our national saving rate was the major factor in giving us these trade deficits. I think if we are going to turn them around, turning that fiscal position around is essential in order to release the resources required in order to generate the exports and substitute for imports that we require.

Senator **Bradley**. Dr. Choate.

Dr. **Choate**. I would say it is major and significant, but not the only contributing factor. I would say reducing the Federal budget deficit is a necessary, but an insufficient condition, for reducing our trade deficit.

Senator **Bradley**. How much of the trade deficit with Japan would you attribute to trade barriers and how much to macroeconomic policy? Dr. Preeg.

Dr. **Preeg**. Well, I do not think anyone can put a precise figure on it. But I would say the major—and then again I am going back to not just the bilateral imbalance but the fact that Japan has a huge surplus projected to rise next year and our deficit, moving the other direction—that the large majority of it would ~~be on~~ the macro rather than on the trade policy dimension of the equation.

Senator **Bradley**. What percent?

Dr. **Preeg**. As I say, I have not seen reliable estimates. People talk about 10 percent. Perhaps some would go somewhat higher. But I would say it would probably be in the range of the 10 percent rather than higher.

Senator **BRADLEY**. Due to trade barriers?

Dr. **PREEG**. Due to trade barriers, that if barriers were removed they would——

Senator **BRADLEY**. And the rest due to macroeconomics?

Dr. **PREEG**. The rest to the basic economics of the——

Senator **BRADLEY**. Dr. Lawrence, do you want to venture into these waters?

Dr. **LAWRENCE**. Well, I think it is impossible to answer the question. To a first approximation, I do not think there is a rigid relationship that any analytical model will give you between trade barriers and the trade deficit. So I would not like to venture an answer.

Senator **BRADLEY**. Dr. Choate.

Dr. **CHOATE**. In the mid-1980's the Commerce Department did some rough calculations taking items that were roughly commodities and they came up with a short list, somewhere in the neighborhood of $17 billion to $20 billion. I would dare say if we would calculate on a product-by-product line, do a cost comparison to try to go to commodities it would probably be that or more. It is a significant amount. The market is closed.

Senator **BRADLEY**. So you say what percent?

Dr. **CHOATE**. I can give you those numbers which constitutes 40 percent of the deficit.

Senator **BRADLEY**. Ten to 40 percent then is the range?

Dr. **CHOATE**. But what I am also saying is, that what is significant is that the Commerce Department and the U.S. Government has not and does not regularly make those calculations on a product-by-product line.

Dr. **LAWRENCE**. But if I could just comment. If Japan imported those $17 billion that would not be the end of the story, would it, Pat?

Dr. **CHOATE**. No.

Dr. **LAWRENCE**. I mean, we would believe that what would happen after that is the yen would get weaker, Japan would tend to export more, so surely that $17 billion is just a starting point—the upper bound on what it could possibly do to that bilateral deficit.

Dr. **CHOATE**. Maybe the yen would not get weaker. They seem to have a very good ability to manage that. So I would not necessarily make that assumption. Particularly when you are dealing with marginal amounts such as that and an economy of that size.

Senator **BAUCUS**. I would like to follow up a little bit on how many of the items on the Structural Impediments list in fact are directly related to market access in Japan. We have heard about the distribution system which certainly by the estimate of most is on that list—that is, does affect market access. Then we get into anticompetitive practices in Japan—alleged anticompetitive practices under the auspices of the Fair Trade Commission in Japan and Japanese statutes. Then we get into inflated land values in Japan, stock market values, et cetera. There are all kinds of mutually exclusive business arrangements such as the keiretsu and vertical integration. I do not have a full list in front of me. But I am certain some of you have.

It seems to me—and I would like your reaction—that despite what some of the witnesses have said—I think Dr. Dornbusch was one, maybe you, Dr. Lawrence, too—that even land values affect market access of American products in Japan and also the inflated stock market affects market access of American products in Japan. The keiretsu certainly does. Other exclusionary practices do.

I tend to think that they do for different reasons. Let's take the market value. It seems to me that if it is true that Japanese land values are four times the total market value of the U.S. real estate—I have seen nobody dispute that. Maybe one of you panelists can and do—that is an opportunity, for landholders, property owners, and stockowners—those who hold securities—to borrow against those overinflated values. It gives them additional market power that American companies do not have in this country.

That additional market power, even if it does not deny access to American products, is in a certain sense unfair because it gives those companies additional market power vis-a-vis the American companies that they are competing with. This also seems to be true for the other exclusionary practices—the anti-competitive and the keiretsu vertical integration, et cetera.

So, is it true that these practices that are on the SII list do affect market access in Japan or do they not affect market access in Japan? Let me start with Dr. Choate and go down the line.

Dr. CHOATE. Well, I do think they affect market access in Japan. That is one of the reasons why they were created in the first place.

The second issue, though, that I think that we have to say is it reasonable for us to ask them to change those processes.

Senator BAUCUS. That is the next question I was going to ask.

Dr. CHOATE. And in my mind, the answer to that is no. For example, the distribution system is a way by which the Japanese maintain a low unemployment rate. In effect, if we are asking them to change the distribution system, we are saying to them, double or triple your unemployment rate. Politically, what is the possibility of that? I think it is very small in a reasonable period of time.

We talked to them on the Fair Trade Commission. The Fair Trade Commission was something that was put into Japan during the occupation. It was imposed upon that particular system. The Fair Trade Commission has a long history of finding anticompetitive practices and then having a benign enforcement of those particular practices.

On the question of the keiretsu, it is a long established operation coming out of the Zibotsu. It is a mutation of reform of organization that the Japanese have had for a great deal of time. The Japanese, I contend, are not fair. The Japanese are simply operating as the Japanese operate.

The question is: If we wish a different set of behaviors, then what must we do here in the context of the relationship?

Senator BAUCUS. So you are saying it is proper for us to ask Japan to dismantle those anticompetitive——

Dr. CHOATE. No. I do not think it is proper for us to ask them to change their society and culture and organizational structure. I think it is very proper for us to say what kind of bottom line results that we want in this joint bilateral economic relationship. That is reasonable.

Senator **BAUCUS**. But will that necessarily include Japan changing some of those practices?

Dr. **CHOATE**. That is their responsibility. How they do it is their choice.

Senator **BAUCUS**. Okay. Dr. Lawrence. I'm sorry. My time is running up. Go ahead.

Dr. **LAWRENCE**. Okay.

Well, I think that there are barriers represented by these features which have been identified. I would speak about land use rather than land values. The critical factor is that the Japanese are misusing their land in a way that is——

Senator **BAUCUS**. Right.

Dr. **LAWRENCE**. I mean wasting it on growing things and so on. I think we——

Senator **BAUCUS**. Intentionally by some at the top.

Dr. **LAWRENCE**. Yes. But I have a different philosophy. You see, I think in an interdependent world economy it is impossible to simply say, what you do is fine and what we do is fine. Because I think——

Senator **BAUCUS**. That is the question I am getting at.

Dr. **LAWRENCE**. Exactly. If you have a vision—and I do—that at some point in the future, 20 years down the road, what we want is not simply a single European economy, but a single world economy, then we have to learn how to adjust the structural friction points that occur across economies. I do not see any substitute. Just as I welcome the Japanese telling us what they find difficult about our society; I think we have to tell them what we find difficult about theirs.

Senator **BAUCUS**. My time is expiring here. Just briefly, though, what should our position be on these talks? What should that mutually agreed upon goal be?

Dr. **LAWRENCE**. I think it should be to set a vision for a single, integrated marketplace sometime in the future, to ask what concrete steps are required to achieve that, to establish that blueprint and then to negotiate over it.

Senator **BAUCUS**. Based upon free trade and competitive, nonexclusionary free market principles?

Dr. **LAWRENCE**. I believe that that is what we should be trying to persuade them.

Senator **BAUCUS**. Okay. Dr. Preeg, do you have a view?

Dr. **PREEG**. Just very briefly. I think all of these are legitimate issues of negotiations on the agenda. We should put a particular focus, however, on access to their market for our companies, rather than on the cultural and the more traditional aspects of these policies. They have made commitments in the GATT, in the OECD and to us elsewhere that we would have access.

Senator **BAUCUS**. Okay. Very briefly. My time is expired. I want to give others a brief amount of time.

Let's assume that they keep the land values and overinflated stock market and all these other practices which some say is not market access, but do have the effect of very definitely damaging American companies in other markets around the world, whether it is the United States or other countries. Are those off limits are should they be addressed?

Dr. **Preeg**. They should be addressed and Japan should change.

Senator **Baucus**. In this forum, in the SII?

Dr. **Preeg**. This should be out front, very forcefully. At the same time in the GATT or wherever else they have made their commitments and they do need to change.

Senator **Baucus**. But in the SII you believe those should be addressed?

Dr. **Preeg**. Definitely, yes.

Senator **Baucus**. Okay. My time has expired.

Senator Rockefeller.

Senator **Rockefeller**. Morita and Ishihara wrote a book which has not been legally translated into English. It is interesting because it is a book that one would expect. Morita has been saying these things to us in English for many years. Ishihara is a different person. One can argue whether Morita should have associated himself with Ishihara. But, nevertheless, the book is being treated as a great shock, although I am not sure what kind of a shock it really is.

I mean it is a rather natural book for some Japanese to have written. I want to get back to this question of how far can you push Japan without doing damage to the underlying relationship. One can argue, in fact, that the Japanese have been responsive on a number of issues—on its sales tax, and removing commodity taxes, on public works, the pressure to consume more, save less, spend more within their own country, leisure time, overseas development assistance has surpassed our own.

One can say they have shown a good deal more courage, in fact, on internal financial movement than have we in this country who are traumatized by one person's lips. They deserve credit for that.

On the other hand, we still have the $55 billion bilateral trade deficit, and something has to be done. And face it or not, even if we were solving trade problems with other countries, which we are not, the Japanese would be a special case, simply because here are the two of us competing to be number one. We have been; they want to be. There is just so much emotion wrapped up into it that friction is unavoidable. Now my question is: You have all previously said that denying them our market is the only way that you really see them changing, in spite of some drastic changes which I have suggested they have already made.

Also, you agreed, and others did yesterday, that even if markets were open to our total pleasure, what we wanted, it might reduce the trade deficit only between 10 and 15 percent, maybe 20 percent. So then we are concluding logically, are we not, that market opening through denying our markets or other tools really is not going to make a significant difference and that we are saying that American patterns of behavior may be substantially more important than market opening in Japan.

I am rather surprised to hear myself say that, but I think it is an interesting question and I would be interested in your views.

Dr. **Choate**. Overall it will. In our total trade balance it is much more important than opening the markets in Japan. But it seems to me that the question that we must ask ourselves is: Is there an internal dynamic inside Japan to upset the harmony with inside their own system for our benefit? I do not see that.

It would seem to me that the only way that we are going to be able to persuade the Japanese to buy more American products—and that is, after all, the purchase of SII in the final analysis—is that we must concentrate on specific measurable results and time tables, rather than demanding processes or in somehow or another inducing the Japanese to adopt an Anglo-American free trade perspective and model.

Senator ROCKEFELLER. So you are saying that it is the principle of access which is more important than the numbers? It is the principle of fair trade more than the results of fair trade? Because you appear to have agreed that the results of fair trade will be minimal.

Dr. CHOATE. It is, I think, both the principal of access and also the amounts that are taken. It is the principal of reciprocity and it is also the amounts of goods that are taken. It is both.

Dr. LAWRENCE. I think that if you view the trade deficit as the problem and the trade balance as the problem, that a more open Japanese market will do very little to change that picture. So the description that you gave, which is that even if we were free to sell there, would we still have substantially the same sized trade deficit in the aggregate and bilaterally, my sense is broadly, yes, probably we would.

Senator ROCKEFELLER. Does that mean therefore that it's worth doing?

Dr. LAWRENCE. No, there I would disagree. Because I do think there is a question of trying to ensure that the two of us can actually have a stable trading relationship. I think that as long as there is this asymmetry or perceived unfairness in the relationship, as long as there are these major structural difficulties for the U.S. firms in selling in Japan, the whole relationship has been called into question.

So I think it is really that. It is a political dimension.

Senator ROCKEFELLER. I have to follow up on that, Mr. Chairman. I understand your point. But it seems to be not a strong one, in the sense that what we are doing has to be based on the trading aspect of our overall bilateral relationship because that is the part which is uncomfortable and which certainly gathers such attention. You say that even with full access the trade results, the exporting results, in the United States are probably not very great. But we still have this fascination on penetration and opening up markets, on redoing the distribution system.

So it is really the principle. It is our souls that we are talking about, more than our boat loads of goods.

Dr. LAWRENCE. I do not want to say—see, I think you have expressed the whole thing in quantitative terms. You have expressed it in terms of the dimension of the trade deficit and imbalance. I think where it would make a major difference is in prices—in prices in Japan. I think that this SII's major thrust is making the Japanese better off. I genuinely believe that.

I look at the costs that Japanese consumers pay for food and for other products and I think Japan is a wonderful country when it comes to production. They are very efficient. But when it comes to delivering a living standard for its citizens, I think it has done very poorly. I think that is a major thrust of SII. So I think it would make a major difference, actually, to the Japanese.

Senator ROCKEFELLER. But Pat, you see, is saying that should not be our business. We are not trying to tell them how to redo their society.

My time is up.

Senator BRADLEY. Senator Heinz.

Senator HEINZ. Thank you, Mr. Chairman.

I find it interesting that nobody has yet addressed what you might call the micro consequences of the bilateral trade relationship that Japan has with us and so many others. The consequences that some of us see are the kind of irreparable harm to critical industries, some of which has not been exactly by accident. Nobody denies that Japan has long had a practice of industrial targeting, nor that HDTV is a good current example of it.

Any comment on that?

Dr. CHOATE. Yes, I would comment. That Japan, much like a spotlight moving across the landscape has picked off one specific industry after another. There is a common practice in how it is done. It begins with farming and production cartel at home, controlling the market, doubling the prices. In effect, taking advantage of Japanese consumers, taking the monopoly profit, using that to engage in and the TAC upon industry off shore, dumping of specific products in cases paying kickbacks to foreign importers engaging in a massive political campaign to undermine any criticism of their activities to consolidate the industry then use that as a base to leap forward to other industries.

Senator HEINZ. Dr. Lawrence, Dr. Preeg, do you disagree with that assessment?

Dr. LAWRENCE. Well, I think it is very exaggerated.

Senator HEINZ. Well, but is it fundamentally correct?

Dr. LAWRENCE. I think that there has been a process of nurturing industries and that the protection given from the domestic market has in some cases helped them.

Senator HEINZ. So the answer is yes, but it is not as bad as he says it is?

Dr. LAWRENCE. I think that is right.

Senator HEINZ. Yes. Dr. Preeg.

Dr. PREEG. Clearly some segments of high tech industry in Japan, also in Europe, and we talk about it here, are being nurtured—if that is the word. It should be stronger than that. We need to have a policy response.

Senator HEINZ. Okay. All right. You know, there is a range of agreement here. Some see it blacker; some see it a little less black. But you all agree, that Japan is playing a different game than they are supposed to under the rules.

Now how many of you would say that Japan does, in fact, operate like a normal free market, capitalist economy? Dr. Choate, you would say that they do not——

Dr. CHOATE. Absolutely.

Senator HEINZ [continuing]. Operate normally.

Dr. Lawrence.

Dr. **Lawrence**. Well, I think they do deviate. But, you mentioned the rules——

Senator **Heinz**. Okay. I want to get to another question.

Dr. **Lawrence**. Okay.

Senator **Heinz**. Dr. Preeg.

Dr. **Preeg**. I think it is a mixture and it is moving, however slowly, in the right direction toward a more market oriented economy.

Senator **Heinz**. Okay. Let's assume for the moment that it is not moving in that direction. Let's assume that it is more like Dr. Choate's analysis. Let's assume, in fact, that Karel von Wolferen is more right than wrong when he says in effect that what you have is a system that is geared to producing the maximum amount of unconstrained economic power, period. That is what it is all about.

Now if that were the case, if we could prove beyond any question that that is the way the relationship between the Diet and the bureaucracy and the industry that all the bureaucrats go into after they reach their early retirement age, if that was the fact, Dr. Preeg and Dr. Lawrence, what would you tell us to do as policy makers? What would you advise?

Dr. **Lawrence**. I think this is exactly where the issue of dumping comes in. I think this is precisely what——

Senator **Heinz**. We have tried——

Dr. **Lawrence**. I would question whether we have applied our own rules. I think what we have done is we have given quotas. So what we have allowed the Japanese to do is to charge us high prices for our steel and to earn high profits.

Senator **Heinz**. I was here for that earlier.

Dr. **Lawrence**. So what I would do, where I found evidence of the practices that you described, is to put——

Senator **Heinz**. But that is not my question. Suppose you concluded that that is the pervasive pattern, the pervasive pattern, and that yes, you could file 10,000 suits, petitions on dumping, on subsidies, on unfair trade practices, but that is unrealistic. I mean, if you really came to the conclusion, not that they were guilty here and guilty there, but that they have an economy totally committed, a system that feeds off of more economic power without any constraint, that does not really buy into the concept of the GATT, which is that somehow nobody should get too far out of line, otherwise the entire system comes to a halt. What would you do?

Dr. Preeg, maybe you want to take a crack at it.

Dr. **Preeg**. I think if that were the case——

Senator **Heinz**. And this is a hypothetical question. I want to emphasize that.

Dr. **Preeg**. If that were the case, it would be primarily a centrally controlled economy like the Soviet Union. We are not letting the Soviet Union into the GATT and we should keep all our options open to put quotas or whatever other responses we would have against a nonmarket economy.

Senator **Heinz**. I am not quite sure what your answer is. What would we do?

Dr. **Preeg**. That if it were truly a nonmarket economy——

Senator **Heinz**. I didn't say it was nonmarket—I said it is a different——

Dr. PREEG. Well, different in that the other forces override market conditions in a pervasive, predominant way, it is a totally different trading relationship. Then we would have to have a much more forceful, more flexible response in putting on quotas or whatever other restrictions we felt were necessary if the other side is not following the GATT or market-oriented trading practices.

Senator HEINZ. I think my time has expired.

Senator BAUCUS. Senator Bradley.

Senator BRADLEY. Yes, thank you, Mr. Chairman.

In the last 2 years, have exports from other countries to Japan increased, do you know?

Dr. LAWRENCE. Yes.

Senator BRADLEY. By how much?

Dr. LAWRENCE. Well, in 1985 Japan—actually, just to give you a number over the year of 1988 to 1987, it was up 15.6 percent.

Senator BRADLEY. From what country?

Dr. LAWRENCE. Well, these are very broad.

Senator BRADLEY. Worldwide?

Dr. LAWRENCE. Worldwide.

Senator BRADLEY. And the U.S. import increase has been how much?

Dr. LAWRENCE. Over that period in 1988—I just want to make sure I am getting the right numbers—it looked like 7.2.

Senator BRADLEY. 7.2 percent. So that U.S. exports to Japan have increased less than the overall worldwide exports to Japan?

Dr. LAWRENCE. Well, but it is very sensitive to the period. There are other periods—in fact——

Senator BRADLEY. You used the 4 year period earlier where there was a 100-percent increase.

Dr. LAWRENCE. Yes. I do not have those numbers off the top of my head, Senator.

Senator BRADLEY. Okay.

I want to ask the question because earlier one of the panelists, Professor Dornbusch, suggested we request a 15-percent increase in the value of U.S. exports to Japan. If that increase is not attained, we should hit them with a surtax. And someone later pointed out, 15% was a low number compared to your comment that there had been a 100-percent increase but that that started from a low base.

My question then would be: Well, a 15 percent increase from a low base is not really asking too much; is it?

Dr. LAWRENCE. No. In fact, that is what they have achieved. They have more than achieved. Professor Dornbusch in a paper where he advocated this pointed out that in fact Japanese imports from the United States have more than achieved his advocated target over the last 4 years.

Senator BRADLEY. Do you have any comment, Dr. Choate, on that?

Dr. CHOATE. I think your point about the low base is the relevant point. I think there is also the question——

Senator BRADLEY. But I mean, does anyone want to comment on the approach that says, you have to increase your U.S. imports by "X" amount or there will be a surcharge?

Dr. PREEG. I just want to say that I think the right approach, the right target, should be on a multilateral basis. Certainly the Japanese surplus has to come down, but the measure should be multilateral, not bilateral.

Dr. **Lawrence**. And I do not favor imposing arbitrary quantitative numbers on Japan.

Senator **Bradley**. Okay. Dr. Choate.

Dr. **Choate**. We bill this as a special relationship with Japan. That would seem to me to speak toward special responsibilities on the part of the Japanese to the United States, given the role that we have played in protecting them in the foreign policy community and in military.

It seems to me that an integral part of this must be one of determining how we are going to integrate the whole of our policies towards Japan and not simply bifurcate them in to trade versus the balance of policies.

Senator **Bradley**. Right.

So are you saying if we did not have any defense forces in Japan then we would not have a basis for arguing that they increase their imports?

Dr. **Choate**. No. I mean the basis that we argue their imports is on the basis of what we take of their market. The question I think that we would argue with them on is the basis of the totality of the expenditures that we make to them and say to them, what is their reciprocal responsibility to us.

Senator **Bradley**. But let's assume we do not have any defense relationship.

Dr. **Choate**. Fine.

Senator **Bradley**. They still produce more goods than we want and we produce less goods that they want.

Dr. **Choate**. Then in that case what we do is we talk about what should be the bottom line results between our two economies, particularly as long as Japan operates with a very different set of economic principles and competitive practices.

Senator **Bradley**. So all policy considerations aside, when it comes down to it, you support the idea of managed trade with Japan, with very specific quantitative targets, with retaliation on both sides if those are not met.

Dr. **Choate**. I would talk about managing the whole of the relationship—imports, exports, investments and competition in third markets.

Senator **Bradley**. Competition in third markets?

Dr. **Choate**. As we saw in the semiconductor accord, one of the things that happened is we saw dumping of semiconductors in third markets which was a means to undercut the American manufacturers.

Senator **Bradley**. How would you——

Dr. **Choate**. There are many ways to get advantages. It is a question that we must be sophisticated enough to deal with all of those ways.

Senator **Bradley**. Yes. Is there a paradigm for your point in the history of world trade?

Dr. **Choate**. As a paradigm, no. But we have never faced a circumstance such as this before either.

Senator **Bradley**. So do either of you know a paradigm of this extent, of managed economic relationship between two nations in the history of world trade? I mean, was British mercantilism worse than this?

Dr. **Lawrence**. No. I think this is clearly much more extensive.

Senator **Bradley**. Okay.

Dr. **Lawrence**. I don't even know if COMECON is the appropriate paramount.

Dr. **Preeg**. No. We had a problem with Britain over 200 years ago and we took——

Senator **Bradley**. Let me ask you, if what we are talking about is increasing our so-called competitiveness, you know, as opposed to simply trade numbers, is there anything that would increase our competitiveness more than increasing our own productivity?

Dr. **Choate**. It seems to me that there is a dual agenda that is required here. Obviously, we have to increase our competitiveness and obviously that will require a package of measures that begin from reducing the budget deficit, lowering the cost of capital, and a whole series of other micro actions.

But I am also suggesting to you that building the best product, with the best technology, involving the cheapest price and marketed and serviced with a religious fervor, all the five foundations of first-class competitiveness, in and of itself does not guarantee success. You have to have access to the market.

If you can achieve it in Europe with free trade principles, then that is the way to go. If you can achieve it in Canada with a free trade accord, then that is the way to go. If however we are dealing with a fundamentally different economic system operating under different premises, then we require a different approach to that system. The political dimension of it becomes as essential as the economic principal.

Senator **Bradley**. Right.

Dr. Lawrence.

Dr. **Lawrence**. Well, I agree that—I think productivity is the most important. I would just like to comment and say that I do not understand——

Senator **Bradley**. Could you explain—don't get into debate with another panelist, but try to explain why productivity is the most important aspect of international competitiveness.

Dr. **Lawrence**. Well, I think ultimately what is important for a nation is the living standards that it can provide its citizens. That is going to be ultimately determined by how productive your workers are. It is really—if America is going to be the world's richest nation, it has to be the world's most productive nation.

So in that sense, there is an intrinsic link between your productivity and your international competitiveness.

Senator **Bradley**. Dr. Preeg.

Dr. **Preeg**. I would agree and just add one thing. Productivity today means moving forward in new technologies, both developing and applying them. That not only has the economic consequence you just mentioned but also has a national security consequence, because we have to stay out front in productivity and new technologies to maintain our edge in national security as well.

Senator **Bradley**. One last question and then we are going to close this panel off.

Could you tell me, are any of the impediments cited in the SII action susceptible to GATT action? I mean, can we deal with any of these issues like the distribution system or land use in a multilateral context since at least two of the three here have urged that we deal with issues in a multilateral context?

Dr. CHOATE. Senator, we could deal with it and we could get a finding. I think that the finding would be ignored, which is their prerogative.

Senator BRADLEY. Would you describe how we would deal with them, Dr. Preeg, if we were going to do it in a multilateral context?

Dr. PREEG. I think we should do it in parallel. If there are investment measures that hurt our export interests and nullify the GATT commitments made by Japan, we can bring that case in GATT. In the OECD, the Japanese have a commitment on the invisibles code, that our engineering and construction companies should have full access to their market. We don't. We should call them and press them on that and use every example. I think we should do that.

I think it not only could be more effective in just a purely economic way, but politically it might be easier for Japan to take decisions if we are pressing them both bilaterally and in the GATT and in the OECD.

Dr. LAWRENCE. I would just add the land use question. It seems to me that that does really boil down to, in a major way, to Japan's agricultural policies. That is an area where I do think the GATT is the appropriate forum, simply because we cannot exert the multilateral pressures on Japan to rationalize the distribution of land because clearly today there are subsidies being paid to farmers. There are quota protection being given to farmers and the GATT would be a place to deal with those issues.

Senator BRADLEY. Let me thank all three of you very much for your testimony. I am sure that the Committee found it as interesting as I did. Thank you very much.

Dr. CHOATE. Thank you. It was very stimulating.

Senator BRADLEY. Our last panel consists of Mr. Robert H. Rines, Ph.D., J.D., president and professor of law, Franklin Pierce Law Center, and lecturer on patents and innovation, electrical engineering department, Massachusetts Institute of Technology.

Mr. Rines, welcome to the subcommittee.

Dr. RINES. Thank you very much, Senator.

Senator BRADLEY. You may begin.

## STATEMENT OF ROBERT H. RINES, PH.D., J.D., PRESIDENT AND PROFESSOR OF LAW, FRANKLIN PIERCE LAW CENTER, AND LECTURER ON PATENTS AND INNOVATION, ELECTRICAL ENGINEERING DEPARTMENT, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CONCORD, MA

Dr. RINES. I would like to apologize for not having a prepared statement in view of the shortness of time. But I would like to ask your indulgence to be able, perhaps, to give a few introductory remarks over the 5 minute interval.

The area in which I have been asked to testify relates to the question of whether Japan, in the way it administers its patent system, is creating a trade barrier. I think we heard a little earlier today that there is some dispute as to whether the panacea here is that we can sell in Japan's markets.

What about the problem of Japan taking our technology and selling all over the world, never mind in Japan's markets. There I would like to tell you three little stories.

I was privileged to represent H.H. Scott, who was one of the two pioneers in high fidelity and stereo technology. There was no such word as stereo. I was there the night that Scott borrowed it from physics in optics. And in the early days of stereo, indeed, you used to have an AM station and an FM station to test whether the thing was any good.

Mr. Scott invented a whole host of patents dealing with stereo technology. All of a sudden we began to witness names we never heard of from Japan—Kenwood, Panasonic, Sony—all kinds of people invited to come to this country with their cameras and other things and get very interested in this technology.

Gentlemen, I must remind you, that in this period from the 1950's to the early 1980's, this country was extremely hostile through its Federal judiciary to the patent system. This country. We even had a breaking point where two justices in *Jungerson* vs. *Ostby* told the truth. Justice Frankfurter and Justice Jackson. They said, while the patent office may have a passion in the United States for granting patents, the remedy is not the equally great passion in this court—the Supreme Court—for striking them down. So that the only valid patent "is the one this court can't get its hands on."

That is what those of us in the patent profession had to live with from the 1950's until in the early 1980's, until in your infinite wisdom—and it was infinite—you disenfranchised the Federal Courts of Appeals from anything having to do with patents and reposed such in your new U.S. Court of Appeals for the Federal Circuit, which you staffed with patent lawyer/judges in part.

If you ever drop that responsibility our system isn't going to work again. Because now we are excited about our system. People trust it. People are investing. Not like in Hermon Scott's day.

But I want to ask you a question. Because I was powerless to sue all these people at once and to stop them in a system where the courts told you it was 7 or 8 years before you could even get a trial, was it the fault of the Japanese that they took advantage of our judiciary's open invitation to plunder with immunity?

The second story I want to tell you. About a year and a half ago I sat with a young client, a doctor of science from the Massachusetts Institute of Technology. He had come to me as one of my students a number of years earlier and said, "I have a brand new technology in the way of inspecting electronic circuits and all kinds of other things. I do what the human brain does. Everybody else is doing it by rote force." He asked me to help him found his company.

I have been privileged in 40 years of practice probably to help more high technology companies get started and to be involved in their development—albeit, primarily in the Northeast part of the United States—than probably any other practitioner in the United States.

What I must say to you is, in helping this young man try to develop his company and his new technology, we tried to go to American industry to license it and to join with a small company. With one exception, nobody had the guts. The one exception was Honeywell.

But what happened with Honeywell was, that after negotiations were all in place and their Optics Division was going to take this whole thing over, we get what we call a new type CEO who came in and without regard to anything said, "No acquisitions." And so, my friends, we were faced with the possibility of seeing this technology go down the drain or be outmoded or see if the Japanese were interested in it.

A couple of weeks ago, Nikon announced this new technology. Our client and I sat in Japan with tears in our eyes. Sure we were making him a millionaire. I got a little piece of the action. We weren't giving a single job to an American. We weren't doing anything but promoting the deficit in this country, but there was no alternative.

The third little story I want to tell you is, we have heard a lot about the way the Japanese administer their patent system.

Yes.

Senator BRADLEY. Could you maybe tell the third story in the course of questions?

Dr. RINES. Delighted to.

Senator BRADLEY. Thank you.

Senator Rockefeller.

Senator ROCKEFELLER. Dr. Rines, the patent problem is a serious one in Japan. Would you agree? In my judgment, it is, and I have held a number of hearings on this in the Commerce Committee. Would you agree that it takes about 6 to 7 years to get a patent in Japan, whereas it would average 18 months to 2 years at the most in this country for a similar——

Dr. RINES. I would totally dispute those figures.

Senator ROCKEFELLER. All right.

Dr. RINES. That 18 months in the United States is a ridiculous figure. We average somewhere between 2½ to 3½ to 4 years in the United States, in my practice and anyone else I know about.

Senator ROCKEFELLER. In the high technology field?

Dr. RINES. High technology field.

Senator ROCKEFELLER. Would you pick one of those; 2½ to 4 years is quite a range.

Dr. RINES. Yes, I would say that is the average for us in a high technology field.

For example, take electronic circuits, things of this sort. That inspection system I told you about. Yes, that took 4 years to bring through the patent office in the United States.

Now whether 6 years is an average in Japan, I cannot tell you. But I do tell you this: That in Japan they have something we don't have, called deferred examination. That is an American company does not have to ask the Japanese patent office to take up their case for 7 years. The practice permeates the American industry of not asking them to examine the case because they want to wait and see what happens to their technology.

Now it could well be 6 years.

Senator **Rockefeller**. Well, let me just challenge that for a moment or at least ask about that. You are saying that high technology, if not patented within 2 to 3 years, probably has been superseded by something else. What would be the sense of a high technology company waiting for 6 years in order to ask for what you have just described?

Dr. **Rines**. Senator, there is none. But what I would like to say is, there is no sense in using the U.S. Patent Office if there is a 2-year life to the technology. Who wants a 17-year patent life if it is only 2 years of technology life. It is ridiculous.

Senator **Rockefeller**. I am trying to get you to calm down a little bit too. Are you saying there basically is not that much difference between the Japanese Patent Office practices and our Patent Office practices in this country; is that what you are saying?

Dr. **Rines**. No, there is a difference. But any American company that wants to get the Japanese patent in an expedited basis has a way to do it, and that was my third story.

I had such an American company 3 months ago on the throes of getting investment to do something in Japan and to sell to Japan. This was a road marker.

What we did was, we went to the Japanese Appellate Tribunal of the Patent Office and under the provisions of their 1987 law said, will you expedite the case for us. We will do what you want us to do to convince you there is an invention here. Within 2 months, Senator Rockefeller, we had acceptance of that Japanese patent application.

So that there are provisions where capital is about to be expended or where it already has been and the businesses are about to be started, that the Japanese Patent Office will expedite, just like the United States will the prosecution of an application.

Senator **Rockefeller**. In our discussions yesterday I mentioned that Jim Abegglen says that between 1951 and 1983, Japan, for $17 billion and through about 42,000 different transactions, mostly with this country, purchased most of the technology which was and has been useful. This is not to say that by any stretch of the imagination that they are only imitators. Japanese are now creators, and they are doing basic research today.

But during this period, in some of these purchases, they also used the leverage of cross-licensing. A majority of key technological innovation in this country comes from small business, in fact, not the largest companies. Those are the people you have been trying to help.

Dr. **Rines**. That's correct, Senator.

Senator **Rockefeller**. So a company is having some difficulties and the Japanese say, well, we will take a position financially, but then there will be a tradeoff. You give us the technology; we will take the position—i.e., cross licensing.

Dr. **Rines**. Yes.

Senator **Rockefeller**. It has been charged by some that that also occurs with respect to the Japanese patent system because of the delay. That is, a technology has value for only a limited number of years, and people pretty much will say, okay, we will give you the patent, but you give us the technology.

Are there inconsistencies or errors in anything that I am saying?

Dr. RINES. Yes, there are, Senator.

This has amazed me in some of the testimony before your earlier Committees. First of all, in Japan, unlike the United States, the minute the fact that you have filed a patent application is published—and this happens within 18 months—that starts the time when nobody can infringe that patent without having to pay consequences later.

So unlike the United States, we do not have to wait for the issuance of a patent to accrued damages against an infringer. Japan provides it when it publishes in 18 months. From that point on, you can begin to notice people, even though you don't have a patent yet.

So, you know, fair is fair, Senator. My feeling is that while the Japanese have indeed spent billions to acquire a lot of technologies and took a lot of technologies, because as I said earlier, at one time we did not have a very effective patent system, we can do business with the Japanese with regard to patents on a matter of almost parity. It really does not make any difference whether we are talking about a Japanese patent or an American patent or a European patent.

Senator, the European Patent Office takes 4, 5, 6 years. I have cases before the European Patent Office in which I haven't gotten a patent though I filed in 1982 and 1983.

Senator ROCKEFELLER. Well, we have some fundamentally different information.

Dr. RINES. You do.

Senator ROCKEFELLER. And with respect to Europe.

Dr. RINES. This is why I welcomed the opportunity to come here. If you would like to see documentation of what I am telling you with regard to specific cases, it is easy to provide. I can provide it right out of my own office.

But remember also, in Europe, the Europeans publish after 18 months. So these criticisms about flooding—the Japanese coming in and flooding with improvement cases and blocking you—that same thing can be done in Europe. But more important, the same thing can be done by Americans if we are on the job. We can watch the Japanese patents that are published in 18 months. We can file improvements. If we are on our job, I see no difference between the two systems merely because one is a little delayed.

Senator ROCKEFELLER. Then that is very encouraging. I just want to say for the record—you say categorically that a 6-year delay in high technology patent giving within the Japanese patent office is simply inaccurate and is not the case?

Dr. RINES. It may be a true statistic. But I am saying I would doubt very much if the American company, whoever it was, that got the 6-year delay, really tried to get that patent out.

Senator ROCKEFELLER. Let me ask if you think that the Japanese Patent Office is entirely independent or if it is responsive to MITI of which it is a part. Do you think this relates to the whole question of Japanese industrial planning, targeting, et cetera. Do you think it is responsive to that or quite independent and operating its own system?

Dr. RINES. Well, I am out of my scope, Senator, in being able to know whether MITI does or does not have any real control. But if you want some observations of my experience with the Japanese Patent Office, they very closely track Don Quigg's experiences. They certainly try to be helpful, getting examiners to help you with your cases and to interview you, assuming you do it in the Japanese style, not just like the United States.

I get the feeling these are independent people. I have never had a feeling, even in the Tokyo High Court, that anybody was looking at me and saying, "Oh, your client is an American." I have never had that feeling. I have always had the feeling we discussed things on the merits. And from that I can only conclude that MITI must give JPO a wide latitude to do things independently.

Senator ROCKEFELLER. Don Quigg, in fact, told me at one of my hearings that Japan's law—referring to the patent law—appears to be administered in a way that makes it a formidable but subtle trade barrier. You have just quoted him, but you disagree with that assessment of his?

Dr. RINES. I am afraid I do not know what he means by a trade barrier. If you will make a couple of assumptions with me, Senator: First that a company is going to really exert effort to try to get their patent through the Japanese Patent Office, not just Americans going over there. I mean using qualified Japanese people. That they are going to put the money into it, that they are going to promptly request examination. That if it is a real commercial thing, they are going to take advantage of the Japanese law which says, we will make it special if you are going to put money in it or a commercial venture, we will handle it fast.

Then I say to you, I see very little difference between trying to get the result of a relatively prompt patent in Japan and in the United States. And, therefore, I do not see a trade barrier.

Senator ROCKEFELLER. The Japanese like to say that their patent system is based upon and taken from the German system. It is my experience that companies in this country do not find fault with the Germany system but do find fault with getting patents in Japan. Am I missing something?

Dr. RINES. You are not missing something. You have hit the nail right on the head. I believe that the people who are whining and complaining about this, have some bone to pick in Japan because they are not able to do something else in Japan. And may be using the patent as the whipping system. Because remember——

Senator ROCKEFELLER. Why would that be in their interest, if they are trying in fact to get a patent?

Dr. RINES. I do not know anybody that has not been able to get a patent in a relatively reasonable time in Japan. In 40 years I have never heard of it, Senator. I am not the only one that would say this to you. I mean, as Chairman of the Patent/Trademark and Copyright Research Foundation and in my other activities, I meet with people all over the world, and particularly Americans.

They do have a grievance. There are things that were expressed a little earlier by the earlier panel. But fair is fair. Let's not use the patent system as an improper bit of hysteria. I just don't have the experience that there is any difficulty in living within the rules of the Japanese Patent Office to any substantial degree.

Since those rules are very similar to the German Patent Office and now the European Patent Office, the same thing goes over there. Why aren't we complaining about that? Why aren't we complaining because we have 4, 5, 6 years sometimes before we get a European patent? Why isn't that a trade barrier.

Senator **ROCKEFELLER**. Well, I assume, especially with high technology, that we are complaining in any place where the patent system takes an overly long time to process patents. You are saying that you have never had an experience with an American company which had difficulty in getting a patent from Japan? That basically speaking——

Dr. **RINES**. Well, I think that is a true statement. I am not saying it might not take us a year longer or something like this. But nothing like 6 years.

I think there is something more important than getting the patent. What do you do with a patent when you have the patent? Who says that system is going to enforce it? Who is afraid of the patent? The Japanese are so clever in using, not just their patents system, but everything else in a quasi adversarial, quasi friendly attitude that you can never come to grips with what do you do about it.

There is almost no patent infringement litigation in Japan. But look what they are starting to do here now that we have taught them that we have a wonderful legal system in the United States that is going to support patents. Now we begin to see them for the first time suing on their own U.S. patents in the United States. We taught them that. That is not their culture. That is not what they do back at home.

It is an overall problem. A patent means nothing by itself. Unless we take the totality of how do you commercialize, how do you innovate, what do you do with it? And that immediately brings you out of the patent office into their legal system, into their trading system, and into some of the real trade barriers that were expressed here earlier today.

Senator **ROCKEFELLER**. So you claim that people who say the Japanese Patent Office responds with a question like, "We have a translation problem in paragraph 3, please, what do you mean by this?", then return it, and then send it back again saying "now we find in paragraph 12 there is a difficulty, could you please explain this.", are wrong?

In other words, this question of delay and stalling is quite foreign to any understanding you have of the Japanese Patent Office?

Dr. **RINES**. What you just described to me is typical of a first or a second action, not just from the Japanese Patent Office. If you will, Senator, from the United States Patent Office. Nearly every patent application in the high technology area where you are trying to talk about new things they do not know about gets the rejection under 35 U.S.C. 112. It isn't clear. It isn't definite. We don't like this language.

I would like the opportunity, with my clients' permission, just to take a few U.S. actions and a few Japanese actions in the same case. Senator, there is no difference. That is the way a patent examiner works and that is the way I worked when I was a patent examiner. And particularly you say translation trouble. If a company wants to pay money to get the right kinds of engineers, they know how to translate it and they know how to go in and explain things to their examiners.

If on the other hand you are operating like many American companies I have observed, on a limited budget—this is all we want to pay—defer the examination—we will take whatever claims they want—I do not think it is fair for them to come later on and complain, "Hey, we didn't get as good a patent. It took us longer. The claims are narrower."

That is not my experience. And I'm certainly ready to document it chapter and verse if you would like to see comparisons of United States and Japanese patents—comparisons of time, claims, office actions. You will find them not only similar to each other, but just like the European Patent Office, too.

Senator **Rockefeller**. Well, that is interesting. Do you know Don Quigg fairly well?

Dr. **Rines**. I do. Donald is a wonderful friend and he has been great to the Franklin Pierce Law Center and I love him.

Senator **Rockefeller**. Would he agree with your assessment of the situation?

Dr. **Rines**. I don't know whether Donald has been in it that closely of recent years. I'm still on the firing line. I am still filing patent applications and I am still prosecuting. I am saying, whether Donald agrees or not, I will show you the evidence. I will give you the cases.

Senator **Rockefeller**. But in your discussions with Don Quigg, would you say that he would agree with your assessment or not?

Dr. **Rines**. Oh I think he would have to agree with that assessment. Now whether he concludes from this that the Japanese are stalling when they say, "I don't like this expression." or "I don't understand this."; and the U.S. Patent Examiner is not stalling when he says, "This isn't clear." and "This isn't statutory." What conclusion he draws, I don't know.

He and I strangely have never discussed this issue of a trade barrier. The first time I knew he was pitching it was when I read what you had put in the Congressional Record, Senator, on his testimony and I was surprised.

Senator **Rockefeller**. So what you are saying then is that our problems with the Japanese Patent Office are our fault?

Dr. **Rines**. Yes. I am saying that's my profession. My clients want Japanese patents, I get them for them. I know how. My associates know how. And I don't go and wait and take 7 years of delay.

Senator **Rockefeller**. How do you go about this? Again, give me the sense of what it is that you do which belies the statistics of a 6-year average wait? How do you go about that?

Dr. **Rines**. First of all, I must say, you know, some of our clients say, "Don't do anything in Japan yet. Don't ask for examination." But they don't complain then that it takes 6 years. But there are other clients, like this one I just told you about recently, who says, "I have to get a patent or I'm not going to get the money to build this company. The Japanese want to put money in it." We just went right to the Japanese Patent Office. No politics, nothing. There is no politics in patent offices anywhere in the world from my experience.

We just went to the Examiner and said, "Look, we are going to put this money in this. Your law says if you are going to put money into something, we'll look at it . . ."—I think they call it a preferred basis. And the Examiner told my associate, "Please, explain to me why these patents that I found aren't the same invention. Give me samples of the invention." He made a whole list. Immediately, within a week, I had those back to my Japanese associate.

I offered to come over and go in to see the Examiner. He reported back, "No, the Examiner says he's satisfied with this." Within 2 months we had our patent accepted.

Senator ROCKEFELLER. Did you think these people who have come before the Commerce Committee to testify have just simply been just lax, lazy, don't know the system, don't drive hard enough?

Dr. RINES. You said it, Senator. But I know some of them that fit that description. It is something a little worse than that. I know some that have very restricted budgets—in fairness, very restricted budgets given to them on what they can do with foreign patents. Then you cannot do what I just described to you. You cannot go making trips to Japan to go interview the Examiner, take evidence, show him experiments and do other kinds of things.

Senator, might I bring up one point that is really confusing to me?

You talk repeatedly about the kind of high technologies that get obsoleted in 2 years. There are some such; but they are not even a candidate for a patent in the United States. Patents don't mean anything unless the technology is not going to be rapidly obsoleted. You can't move anywhere fast enough to do anything in 2 years.

In the United States you say there is an average quoted to you of 18 months. Assume that. How could I ever even go into court with an infringement action? First of all, 18 months to prosecute the patent and it takes the Patent Office 3 more months to print it. So we're already almost in a 2-year cycle. How do I get into the court, in the courts of the United States of America and do anything?

By the time I file my suit, my technology is obsolete. Whoever put that bug in the head of the Senate, I would like to see him and talk to him. Two year technologies are not candidates for patents in any country.

Senator ROCKEFELLER. There is disagreement here, and I am instructed by what you are saying. I pray to God that what you are saying is right.

Dr. RINES. Senator, I will assure you it is. I have 40 years of firing line experience and I am telling it to you the way it is. Any evidence you would like to have me produce, contrary to what you have been told, I will show you tens of my own cases and you will see about this business of narrow claims in Japan, about all these extra times in Japan.

Senator ROCKEFELLER. Well, we may give you that opportunity.

Dr. RINES. I would welcome it, Senator. Because I think this is a little bit unfair. The Japanese are killing us. I admit this. But let's not use the patent system as a whipping boy.

Remember, these are unusual people. These are people who, so far as I know, keep confidences.

Senator **Rockefeller**. I should say as I have said throughout this whole process, I have no criticism of the Japanese patent professionals themselves. In other words, basically they have been a victim, in my judgment, of underfunding. They have a new building now. They still do not have enough people. We are adding a lot more people over here than they are over there by a factor of about 8 to 10. I am not questioning their professionalism. I think you would agree with that.

Dr. **Rines**. Yes, there is something in that.

I am not saying it is quite as fast as our system. But on the other hand, I don't think it is any slower than the European patent system. And, of course, Commissioner Quigg and others have put a big effort in this country to try to expedite the granting of patents.

Senator **Rockefeller**. If somebody had been in Japan for a long time—say 30 years—speaks fluent Japanese, has an optic fiber product which he is trying to sell, and he can't sell much of his product, although it has the highest quality and is the cheapest in the world, this is somewhat of a problem. Motorola was facing that on cellular telephone and to some extent still is, but that is moving a little bit more towards resolution.

That isn't necessarily a patent problem.

Dr. **Rines**. No.

Senator **Rockefeller**. That is a different kind of a problem.

Dr. **Rines**. No. Thirty years of patents would have expired long since, so it is certainly not a patent problem.

Senator **Rockefeller**. Yes. I am not saying he had been trying to do optic fibers for 30 years. I was assuming he was living there for 30 years.

Dr. **Rines**. But was the complaint that he couldn't get a patent in Japan?

Senator **Rockefeller**. No. I'm moving away from the patents a little bit.

Dr. **Rines**. Oh, excuse me, sir.

Senator **Rockefeller**. To other kinds of problems. How would you then generally characterize the problem. It would appear to me that you would be of the school that would say Americans don't have the resources, that those who do have the resources, but who complain about the patent office are doing it simply as an excuse or as a scapegoat or that Americans generally are not aggressive in their approach to patents where they need them.

There are evidently a lot of American companies in high technology who feel they do need patents and have expressed to us the feeling that they are not getting the patents and are upset about the system. Your characterization of them simply would be to say that they are not working hard enough, not trying hard enough or not applying the resources to it?

Dr. **Rines**. Yes, I would say that. But I also remind you, Senator, that you have had people appear before you like the former Chief Patent Counsel of Cibe Giegy who is now a professor at the Franklin Pierce Law Center, who has taken the same view I have from a very different background. His was a corporate background in the pharmaceutical and chemical practice. Mine, while in chemical is not in pharmaceuticals, it is in electronics, it is in mechanical, it is across the board.

I tell you, Senator, I don't know what the motivation is and I am not disputing the statistics.

Senator ROCKEFELLER. Which statistics?

Dr. RINES. You said 6 years or 5 years in the Japanese Patent Office.

Senator ROCKEFELLER. No, but you said you were——

Dr. RINES. That is not my experience.

Senator ROCKEFELLER. And say then again what again your experience is in terms of time.

Dr. RINES. My experience in terms of time is, that if you will promptly elect to have substantive examination when you file your Japanese patent application, that assuming nothing goes wrong in the Patent Office—the Examiner looks at it and says, "Oh, that's good. I'll give you a patent."—the average time my Japanese associates, Furuya & Co., tell me for the Japanese patent is 38 months. I have a letter right here from them. I telexed them. I asked them, please, what is your experience.

Now there will be other kinds of cases where we have to fight with the Examiner. He doesn't recognize the invention. He says it is too close to something else. He won't give us the claims we want. That is just like the United States. That is why you have averages.

I have cases pending in the United States 6 and 7 years. They haven't issued yet. We have some real fights.

Senator ROCKEFELLER. Now, you are very involved with helping small, as I indicated, start-up companies. Some people explain that, as I indeed have, it is not Toshiba or Hitachi or Mitshubishi, it is the smaller companies in Japan as well as perhaps in our own country where some of the new technology comes from.

People say that the Japanese patent system is designed to help these huge companies at the expense of everyone else. In other words, quite the opposite of what I have just said. That larger companies in Japan, from their own perspective, can move patents much more quickly through the patent process. Do you have any judgments on that?

Dr. RINES. Well, yes, I do. Let me take one that is favorable for a moment. I happen to believe now you are hitting at something where I think they take unfair advantage of us. Under the rules of the Japanese Patent Office, the Japanese inventor has to reply within 60 days to the Examiner's rejection. For foreigners, they give us 6 months, presumably because we are far away. Here again, it is showing you something about delay. Nobody told you about that, did they?

Senator ROCKEFELLER. About which?

Dr. RINES. No, about the difference that a Japanese applicant is required promptly within 60 days to reply to the Patent Office, but we are given 6 months and then extensions of time. See, that is in their law. So there are differences between the foreigner or the American or other western or other applicant.

It is my view, in response to your question, that large corporations in Japan do not particularly understand the small inventor, are really not concerned with the small inventor or the individual inventor except when they come to buy technology from one of our small inventors, let's say, or small companies. And they do have a very different philosophy about the patent system.

They are all for licensing. They are all for acquiring compulsory licensing sometimes. And they try to push toward that, even though their law says you can get an injunction for an infringement of a patent. They don't do that very often.

I might say that in this country too, in the 1950's to the 1980's, there were no courts in the United States, or very few, that were giving injunctions on patent cases in that era of judicial hostility. That is something that has just started to be restored with a new integrity in your Court of Appeals for the Federal Circuit.

So there is a different philosophy. But Japan isn't the only one that has compulsory licensing. If people are not making, for example, adequate use of an invention in the United Kingdom, others can apply for a compulsory license. You don't have an exclusive patent privilege. The same way under the European patent system. Now we don't complain about that. It is a philosophy different from ours. We don't complain that that is inimicable to our independent inventor and yet it is.

But you are quite right, the Japanese do not understand. In their culture they do not understand the importance of our individualism, nor do they understand that their system should be particularly administered to allow the exclusive privilege to stand, not that we have to license somebody else. Because without the exclusive privilege we can never start new companies.

Senator ROCKEFELLER. The Japanese patent and intellectual property matters are a subject of discussion under SII. Does that say anything?

Dr. RINES. Yes, it does. But the thing I would question was: How did it get there? It got there on some representation that the Japanese patent system in some people's views was being administered in some kind of a discriminatory way that resulted in trade barrier effects to the United States.

Senator, that may be true. I just tell you in 40 years I have never seen it. I do not see it today.

Senator ROCKEFELLER. Well, that is very clear, Dr. Rines. I mean, your point of view is very clear. I think what is interesting will be to see how that stands up as we pursue this more. I certainly respect your point of view. It is the first time I have heard that point of view, except from the Japanese Patent Commissioner himself, who told me as you did, that there is no problem.

And you two may both be right and I may be quite wrong. I am always prepared to accept that. So this has been helpful and interesting. I would like to be able to pursue this with you in a Commerce Committee context.

Dr. RINES. I would love to do it. I would like not to have just said it, I would like to prove it to you.

Senator ROCKEFELLER. Right. I understand that.

I thank you for your coming here today.

Dr. RINES. Thank you for the opportunity and honor of coming.

Senator ROCKEFELLER. Right.

The hearing is adjourned.

[Whereupon, the hearing was adjourned at 4:23 p.m.]

# APPENDIX

## ALPHABETICAL LISTING AND MATERIAL SUBMITTED

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### PREPARED STATEMENT OF JOHN M. ANDREWS, PRESIDENT, AMERICAN NATURAL SODA ASH CORP. (ANSAC), SUBMITTED BY THOMAS R. HOWELL

Mr. Chairman, I am John Andrews, President of the American Natural Soda Ash Corporation ("ANSAC"). ANSAC is a Webb-Pomerene Corporation representing the six U.S. producers of soda ash, a commodity used in the manufacture of glass, detergents, and other industrial processes. My purpose in testifying today is to report to you on the market access problems which ANSAC has encountered in Japan, which are not a typical of the structural impediments encountered in other industries.

ANSAC's only business is exports, and we are therefore completely dependent upon our ability to secure and maintain access to foreign markets. Because the U.S. enjoys a natural resource advantage in soda ash, we can produce higher quality soda ash, at a lower cost, than any other country in the world. In any open competitive situation, our industry is likely to prevail. We have never confronted an open market situation in Japan, although there are definite competitive opportunities. We attribute the partial success we have achieved to date to the longstanding efforts of the U.S. government on our behalf, as well as some significant actions by the Japan Fair Trade Commission (JFTC) and the Ministry of International Trade and Industry (MITI). Unfortunately, however, while U.S. soda ash sales have increased in the past several years, our sales are still regulated, to a degree, by a group of Japanese soda ash producers and their affiliated trading companies.

#### THE U.S. COMPETITIVE EDGE

Analyses of the causes of the bilateral trade imbalance with Japan are complicated by the fact that Japanese firms have achieved a competitive edge over some U.S. industries, and U.S. firms have often failed to make a major commitment to serving the Japanese market. The case of soda ash is important because it is one industry in which the United States holds a commanding competitive edge over Japan, and where the U.S. industry has mounted a major and sustained effort to penetrate the Japanese market. The fact that we have encountered major barriers, and that the Japanese Government has been unwilling or unable to rectify the problem, suggests that more fundamental problems underline the trade imbalance than factors such as exchange rates or the efforts of U.S. companies.

Our competitive edge is substantial. The Japanese industry, lacking natural soda ash deposits comparable to our own, must manufacture the product through a synthetic process which is heavily dependent on imported raw materials and energy. The U.S. soda ash industry uses substantial less manpower and less energy to produce each ton of soda ash than the Japanese industry. Our cost advantage is so significant that even when the dollar was at its strongest relative to the yen, we could incur the costs associated with exporting the product to Japan (shipping, insurance, warehousing, etc.) and still remain price competitive in Japan. As the dollar has declined in value relative to the yen, our cost advantage has further widened.

We have made a major commitment to expanding our market presence in Japan. Since our large-scale entry into Japan in the early 1980's, we have repeatedly undercut the domestic price (which was far higher than the world price) and Japanese soda ash prices have declined by 35 percent. We continue to price below our Japanese competitors. In order to demonstrate our commitment to our Japanese customers, we have warehoused approximately two months' worth of soda ash inventory at seven locations in Japan, which is more inventory than the Japanese firms themselves maintain. We have contracted with Sumitomo Shoji, a major Japanese trading company (which has no affiliation with Japanese soda ash producers) to distribute our product in Japan. Complaints from customers about the quality of our product have been virtually non-existent. Former Ambassador Mansfield commented several years ago that "I wish that more American exporters were making similar efforts actively to adapt to the needs of Japanese customers."

### JAPANESE MARKET BARRIERS

Japan has a long history of resistance to import penetration in this industrial sector. In 1983, the Japan Fair Trade Commission (JFTC) found that an illegal cartel of Japanese soda ash producers, organized in 1973, was restricting sales of U.S. soda ash in Japan. The JFTC found that these firms regulated the price of soda ash in Japan, allocated market shares and import shares among themselves, and shared the profits and losses among themselves according to an agreed ratio. Directly and through their affiliated trading companies, the Japanese producers exerted pressure on Japanese consumers not to procure imported soda ash through "independent" channels, that is, from a source other than the producers' group itself. The JFTC ordered the Japanese producers to cease this activity, although it imposed no fines or other sanctions. In the immediate aftermath of the JFTC decision, U.S. sales increased from an annual total of 50 thousand metric tons to approximately 210–220 thousand tons—about 15–18 percent of the market.

After this, however, U.S. import volume leveled off, and stagnated thereafter at 15–18 percent of the market. A number of Japanese customers reported renewed pressure from Japanese soda ash producers, and cited that pressure as a reason why they could not increase their purchases of U.S. soda ash, regardless of the price offered. We were told that a de facto quota had been placed on U.S. sales by the Japanese producers. In 1986 ANSAC instituted substantial price discounts, but sales volume did not increase—the net effect of these discounts was a $3 million loss in revenue on ANSAC's existing sales.

In 1987, the JFTC opened a new investigation of the soda ash market. It concluded that while the Japanese producers had not violated the Antimonopoly Law, they were engaging in certain practices which "could be problematic under some circumstances." Specifically, a practice existed under which a Japanese customer receiving an offer from a U.S. supplier first "pre-clears" this purchase with the customer's regular Japanese supplier. We believe that this practice enables the Japanese soda ash producer to apply pressure to the customer to limit or refuse altogether any U.S. purchases. The JFTC regarded the practice as a "gray area"—neither clearly legal nor clearly illegal. It summoned in the heads of the Japanese soda ash companies and warned them to take care not to violate the Antimonopoly Law, and indicated it would continue monitoring the market for evidence of renewed anticompetitive behavior.

In 1988 and 1989, our sales volume in Japan did increase. Our sales reached 269 thousand metric tons in 1988, up from 231 thousand tons in 1987 and 211 thousand tons in 1986. This year we expect that our sales will be 300 thousand tons. We are gratified by these increases, which represent gains in market share as well as aggregate volume. However, a significant part of the increased volume is attributable to factors other than greater market openness. While we have increased our total volume, we have not added new customers. We are concerned about the persistence of structural barriers which continue to limit our ability to achieve the sales volume which is warranted by our competitiveness and commitment to this market. For example:

—There is evidence that our total sales volume in Japan is still being regulated by the Japanese soda ash producers and their affiliated trading companies. At the end of 1988, an order for soda ash was placed with ANSAC by a Japanese trading company associated with the Japanese producers which was inordinately concerned over whether the shipment would count against U.S. totals for 1988 or for 1989—a concern which is commercially irrelevant but quite relevant if someone is trying to administer a quota.

—Some major Japanese soda ash customers refuse to buy U.S. soda ash under any circumstances, regardless of price or other economic factors.

The Japanese soda ash producers and their trading company affiliates, own and operate the Toko Terminal, which is Japan's only port facility dedicated specifically to handling soda ash. Thus if we utilize Toko Terminal our product is handled by our direct competitors, a fact which has caused problems for us in the recent past. ANSAC has been the only user of this facility, and our competitors have received all of the profits from it. The owners of the Terminal have rejected all of our overtures to buy an equity stake in the Terminal in order to gain a voice in its operation.

### U.S. MARKET-OPENING EFFORTS

The U.S. Government has been raising the soda ash issue with the Japanese government for many years. Soda ash has been a regular subject of official bilateral discussions since the early 1980's. In addition, many officials in this and the prior Administration have raised soda ash informally through numerous channels. Our Embassy in Tokyo has taken an active interest in the problems confronted by our industry. Many Senators and Congressmen have expressed their concern over this issue to the Japanese Government, and Senator Wallop, a former member of this Committee, has made two visits to Japan solely to raise the soda ash issue with the Japanese Government.

These efforts have not produced dramatic breakthroughs in our sales efforts. But it has become increasingly clear, with the perspective of time, that they have played a major role in fostering the slow but steady growth in our market position which has occurred to date and which, hopefully, will continue. We are grateful for the support which we are continuing to receive from this Administration.

I should not neglect to point out that the Japanese government has not ignored our concerns. While we would have welcomed firmer action by the JFTC against anticompetitive practices in Japan, there is no question that the two JFTC investigations have fostered a less restrictive market environment that is much more conducive to expanded U.S. sales. Similarly, while some officials in MITI have bluntly told us that we should expect no further grown in our sales in Japan—regardless of economic factors—other MITI officials have worked with us to develop additional market opportunities. This may well reflect their recognition that if Japan's soda ash industry is losing competitiveness, a structural adjustment—leading to increased overseas sourcing—is in Japan's long term interest.

At various points over the past several years, ANSAC has seriously considered seeking relief against restrictive Japanese practices by invoking Section 301. We do not rule out a Section 301 action in the future should our sales encounter increased restrictions, although based on our recent strong sales we have reason to hope that this will not occur. However we have avoided Section 301 action until now because of the adverse effect such an action could have on our relations with our Japanese customers. We have instead chosen to employ a highly competitive commercial effort, coupled with close monitoring by the U.S. and Japanese Governments to ensure that our sales are not blocked by restrictive actions. This approach has produced some tangible gains, although we remain concerned that our current market position in Japan could deteriorate rapidly if U.S. government monitoring is not maintained.

### CONCLUSION

I think that several lessons can be drawn from ANSAC's experience in Japan. First, the bilateral trade imbalance is attributable to more than macroeconomic factors such as the exchange rate and savings rate, and U.S. trade policy that is based only on the exchange rate is unlikely to eliminate the bilateral deficit. In our case the deficit had nothing to do with our problems in Japan. Second, it is clear that more vigorous enforcement of the Antimonopoly Law by the JFTC would help to open up additional market opportunities for U.S. firms in Japan. Finally, it is important for U.S. industries seeking to penetrate the Japanese market to work closely with the U.S. government when they encounter market barriers. In many cases, unfortunately, simply being competitive and making a major commitment to serve the market isn't enough.

Structural impediments to U.S. sales in Japan are one of the most significant trade problems which this country currently faces. I commend your Committee for drawing attention to this problem with these hearings and I hope that this summary of our experience has proven of some value to you in assessing an appropriate U.S. policy response.

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## PREPARED STATEMENT OF WILLIAM T. ARCHEY

I am William T. Archey, Vice President, International, of the U.S. Chamber of Commerce. The Chamber welcomes this most timely opportunity to comment on the ongoing Structural Impediments Initiative (SII) discussions with Japan.

As you know, on May 25, the Administration announced that certain restrictive trade and investment practices in Brazil, India and Japan would be subject to proceedings under the "Super 301" provisions of the Omnibus Trade and Competitiveness Act of 1988 (1988 Trade Act). Those practices included quantitative import restrictions in Brazil; Japanese exclusion of foreign suppliers of satellites and supercomputers from government procurement; Japanese technical standards that unduly restrict importation of forest products; restrictive trade-related investment measures and barriers to trade in insurance services in India.

Also on May 25, the Administration announced that a number of "structural impediments" to Japan-U.S. trade would be subject to "parallel" consideration, outside the Super 301 procedures and timetables. According to the U.S. Trade Representative's (USTR) announcement, "these negotiations will address structural impediments to trade and balance-of-payments adjustment, and such anticompetitive practices as bid-rigging, market allocation, and group boycotts. The negotiations would initially focus on major structural barriers to imports, such as rigidity in the distribution system and pricing mechanisms."

The Chamber remains a strong supporter of the 1988 Trade Act and its aggressive implementation. In particular, the announcement of Super 301 proceedings was not only crucial on the substantive merits but also an important recognition of American political reality. Many of the Chamber's members continue to encounter numerous anticompetitive barriers to entry into the Japanese market. Moreover, polls show that a significant majority of the American public believes that Japanese economic prowess poses a greater threat to U.S. interests than does Soviet military might. Given this attitude, the public will not long tolerate a trading system that in effect amounts to an "open door" policy toward most Japanese imports while the Japanese Government either imposes or tolerates wholesale impediments to U.S. exports.

The 1988 Trade Act's legislative history makes Congressional intent very clear. We disagree with critics who maintain that the Super 301 provision is protectionist; rather, we see it as Congress intended, to be aimed at opening markets, not closing them. This provision was designed to combat generic or systemic practices that restrict U.S. access to foreign markets across the board. Specifically, the law requires that the USTR seek negotiated agreements that will result in the elimination of "priority" trade restrictions in "priority" countries over three years, with the expectation that U.S. exports will increase over that period. The law also requires that elimination of the identified trade barriers have the greatest potential to increase U.S. exports, "either directly or through the establishment of a beneficial precedent."

The Chamber strongly supports aggressive use of Super 301 procedures to obtain trade liberalization agreements with Japan and the other designated countries. To facilitate this process, the Chamber obtained information from numerous companies and trade associations with worldwide interests and American Chambers of Commerce abroad, as well as from earlier National Trade Estimates reports and other official sources. It was in this spirit that, on March 24, we submitted extensive documentation of barriers to U.S. trade in four countries, including Japan. Also in keeping with the letter and spirit of the Super 301 provisions, our documentation focused primarily on structural and trans-sectoral trade distortions. In Japan, distortions that we cited included distribution systems and restrictive business practices that discriminate against foreigners and would in many cases constitute antitrust violations if they occurred in the U.S.; so-called administrative guidance, which includes threats of punitive action against organizations that purchase imported goods; public procurement practices that effectively exclude most foreign competition; granting import licenses only to Japanese importers and not foreign exporters, which sharply limits foreigners' ability to gain market penetration on their own or to switch importers if they are unsatisfied; and others.

The Chamber continues to have reservations over the SII process that was set in motion on May 25. While the concerns of U.S. satellite, supercomputer and forest products vendors were subject to specific timetables and procedures established in Super 301, no such timetables and procedures were applied to the systemic trade barriers in Japan (or Brazil and India, for that matter), which were targeted generally by the 1988 Trade Act and in greater detail by the Chamber's Super 301 submission. Indeed, the SII is not subject to any specific milestones or criteria for progress beyond those that the negotiators choose to apply.

Our reservations notwithstanding, the Chamber also recognizes that the SII is the currently operative U.S. approach for resolving structural trade problems with Japan and should be given a chance to succeed. Our negotiators need our fullest support as they seek to resolve some of the most pressing foreign economic policy problems that this Administration will face. For this reason, the Chamber does not support at this time efforts to impose by legislation Super 301-style deadlines and procedures on the SII. However, the Chamber does support USTR Carla Hills' approach to the problem as she articulated it at the Chamber's International Forum breakfast on Friday, October 27. At the breakfast, she stated that by next spring, she expected a "blueprint" of specific steps and milestones toward the eventual elimination of the structural impediments. We will be watching to determine whether or not this blueprint is genuine or merely cosmetic, as has so often been the case with Japanese market- opening commitments.

I should note that increased market access resulting from resolution of these problems will benefit not only U.S. exporters but also exporters from third nations and, indeed, Japanese consumers who pay higher prices as a result of trade restrictions. It also needs to be emphasized that asserting America's legitimate trade interests is not protectionist It is what almost all developed countries do for their companies and their interests. As my former boss and good friend, the late Commerce Secretary Malcolm Baldrige, once said: "If trade is not fair, then it won't be free very long; the best antidote to protectionism is to aggressively assert America's legitimate trade rights in the international market."

As important as Japanese trade liberalization is to U.S. commercial interests, we must not forget that the SII is and should be a two-way street, that is, a forum for correcting some of the home-grown U.S. deficiencies that undermine U.S. competitiveness in Japanese and other foreign markets. U.S. interests require that other major issues falling outside the traditional scope of trade policy also be addressed. U.S. interests and policies must be thought of in more generic terms, encompassing broader issues of national concern, such as our investment and savings rates, the high cost of capital, the quality and relevance of our education system and our ability to commercialize our research and development programs.

The U.S. has some serious problems here that also need to be resolved if it expects to improve significantly its competitive position in world markets. The average annual increase in U.S. investment in plant and equipment lags behind all of the other Group of 7 nations. U.S. capital costs are significantly higher, personal savings rates are lower, and students' scientific and mathematical proficiency is substandard. At stake here is nothing less than the economic viability of both the U.S. industrial base and human resources in the highly technical and competitive global economy of the 1990s and beyond.

Despite the urgency of these problems, the U.S. government is not only not export-minded but also unique among industrial nations in its ambivalence about what role it should play in trade and investment promotion. Take mixed credits—combinations of export credits and subsidies with foreign aid. The U.S. has been seeking an international agreement to eliminate all government subsidized export financing. However, until the practice is eliminated universally, the U.S. should be prepared to counter these subsidies, which result in highly favorable financing terms for participating countries. According to an Organization for Economic Cooperation and Development report on mixed credit activity worldwide during 1984-1987, total activity was $35 billion. While $24.5 billion, or 70%, of such activity was attributable to four countries (Japan, France, Germany and Italy), the U.S. put up only $1 billion, or 2.9%. Overall, we estimate that foreign mixed credit export financing is costing the U.S. from $2.4 billion to $4.8 billion annually in lost exports for capital goods industries. Take the U.S. and Foreign Commercial Service (US&FCS). During the last ten years, there has been an ambivalent attitude toward US&FCS on the part of the executive branch as to whether government should even be involved in export promotion. As a result, the US&FCS has not received the necessary senior-level support and has been consistently underfunded. However, it does appear that export promotion is receiving more attention from Secretary of Commerce Mosbacher. We hope that this will in fact be the case and will be reflected in both the US&FCS budget and programs.

The point is that it makes little sense for the U.S. government to seek open markets while continuing to neglect its own export promotion and financing programs, if the net effect is to open those markets to foreign competitors that are aggressively supported by their governments.

At the heart of this ambivalence is the executive branch's continuing reluctance to recognize that U.S. national security is fundamentally dependent upon its economic vitality, especially in today's marketplace. Other countries understand very well the importance of economic vitality in today's global marketplace. It is very clear that, in the 1990s, more of our foreign policy and security relationships will be defined in economic terms. However, we have yet to understand what our competitors in Europe and the Far East understand very well—namely, that strength in commerce and technology has strategic value.

While the American people understand this, there seems to be little awareness of this within the executive branch, and perhaps even within the legislative branch. Specifically, there is no central forum or decision-making body within the executive branch whereby the economic and trade dimensions of foreign policy and national security policy can be joined. As a step toward filling this void, the Chamber advocates inclusion of the economic agencies (The Departments of Commerce and Treasury and USTR) on the National Security Council as a means to ensure fuller consideration of the economic implications of national security and foreign policy decision-making. Senator Glenn and Representative Gephardt have indicated that they will introduce legislation along these lines in the near future.

Clearly, there is much that also needs to be done by the American business community to match its foreign competition. Much progress has been made along these lines. There has been considerable restructuring of a great deal of American business, particularly in manufacturing, over the last five years with a much greater emphasis on quality, productivity, servicing of products and other elements that make American companies more competitive. This process of restructuring will continue. Indeed, it needs to be recognized that perhaps the increasing competitiveness of American companies would not have occurred if it were not for the challenges posed by foreign competition.

While the U.S. clearly must act to correct its own structural impediments and elevate the importance of trade in its policy-making circles, this in no way justifies weakening its resolve to open foreign markets, whether through multilateral, bilateral or even unilateral means. U.S. businesses continue to face a wide range of trade barriers and distortions in Japan that do not burden Japanese companies operating in Japan or the U.S. We must continue to give the necessary support to our negotiators, and even prod them into tougher positions when they appear to falter. We must make it even clearer that we take our legitimate trade rights very seriously and that we are prepared to take unilateral action if necessary and appropriate to defend those rights.

The U.S. must acknowledge both to itself and to others that it has entered a new era in which the economic vitality of a nation is an intrinsic component of its national security and its influence on the world stage. This means that the government itself must be aware of this reality and, as with all of our developed-country trading partners, must be willing to take a proactive stance toward inclusion of economic interests in foreign policy and national security decision-making. Asserting America's legitimate rights on the world economic stage is not protectionist. On the contrary, it is in the clear interests of not only the U.S. economy but also the world economy and trading system.

This concludes my testimony. I will be happy to attempt to answer any questions that you may have.

## Prepared Statement of Senator Max Baucus

(November 6, 1989)

On May 25th, the Administration announced its plan to implement the Super 301 provision of the 1988 Trade Act. In addition to naming Japan, India, and Brazil as Super 301 priority countries, the Administration also launched the Structural Impediments Initiative (SII).

The Administration billed SII as an effort to address structural economic problems in Japan and the U.S. that contribute to the bilateral trade imbalance. The primary U.S. objective is to eliminate various Japanese structural trade barriers, like the distribution system, price fixing, bid rigging, and vertical integration. The U.S. is also interested in addressing some underlying economic problems that effect trade flows, like the high Japanese savings rate and Japanese land policy. The Japanese rightly responded that there were some economic problems in the U.S. such as the U.S. budget deficit, that should be addressed as well.

When it was first announced, I applauded the SII. I have for sometime urged the Administration to begin discussions with Japan to address these broader structural problems. As the President's Advisory Committee on Trade Policy and negotiations (ACTPN) noted earlier this year, these structural harriers may be blocking as much as $30 billion in U.S. exports annually.

As today's witnesses will attest, everything from U.S. computers to U.S. forest products have been kept out of the Japanese market by structural barriers. If we are ever to gain access to the Japanese market, these structural barriers must be eliminated or at least sharply reduced. Further international pressure could help the U.S. address some of its own economic problems that hinder U.S. competitiveness.

The negotiations began on September 4th in Tokyo. Unfortunately, there have been disturbing reports that the Japanese are less than committed to these negotiations. There have also been reports of inter-agency squabbles in the U.S. holding up the negotiations.

The U.S. and Japan have agreed to conclude the SII in the summer of 1990. A mid-term report is due in March of 1990. These negotiations must succeed. In my view, they are the most important trade negotiations that the U.S. has ever entered into. The U.S. cannot continue to tolerate—either politically or economically—a $50 billion bilateral trade deficit with Japan. The U.S. cannot continue to allow Japanese exporters access to our market while Japan slams the door on U.S. products.

If the trade dispute with Japan is not addressed, the political balance in the U.S. will shift. If the situation does not improve soon, the coalition in support of free trade that has shaped U.S. trade policy since WWII will unravel. The U.S. simply cannot continue to accept one way free trade. If free trade is to survive in the U.S., the Japanese market must be opened. Experience has demonstrated that this is most likely to be achieved through bilateral negotiations.

Today, I have brought together an array of witnesses representing the American business community. We will hear testimony from America's largest general business groups as well as a wide array of specific industries. There are disagreements between these groups on U.S. trade policy. But every one will attest to the tremendous importance of the SII.

I am willing to give the Administration the leeway to pursue the SII on its own schedule. But if SII doesn't work, we must prepare for the next step. The next step, in my view, is to employ the tools of the 1988 Trade Act—primarily an expanded and strengthened Section 301 provision to open the Japanese market.

Obviously, the broad economic problems, such as the high Japanese savings rate and Japanese land policy, cannot realistically be addressed through Section 301. They can only be addressed through broader economic discussions with Japan or through internally driven reform in Japan. But some issues, such as the Japanese distribution system and exclusionary business practices, can be addressed under Section 301. In fact, many of my colleagues intended the Super 301 provision to be used to address exactly these problems. It is even rumored that some in the Administration proposed initiating Section 301 cases on these problems in this year's round of Super 301 cases.

It would be premature to move legislation to require the Administration to use Section 301 in this manner until the SII is given some chance to succeed. But if SII appears to be lagging, I plan to introduce legislation to require Section 301 to be used against Japanese structural barriers should the SII fail. And If the SII is not demonstrating results by next summer, I am confident this legislation will pass Congress.

The second round of SII negotiations are now being held here in Washington. I fully and enthusiastically support the efforts of our capable negotiators—S. Linn Williams, David Mulford, and Richard McCormack. I hope they can convince their Japanese counterparts of the importance of these negotiations.

I recognize that our Japanese friends have made significant strides forward in recent years. But Japan still has a considerable distance to go to open its market. I strongly urge the government of Japan to treat SII as a chance

perhaps the last chance—to resolve our trade problems in a constructive forum. U.S. patience is limited, and the clock is ticking.

## PREPARED STATEMENT OF SENATOR MAX BAUCUS

(NOVEMBER 7, 1989)

For years, Japan has told the rest of the world that Japan is different. Snow ski exporters were told that they could not export skis to Japan because Japanese snow was different. U.S. ranchers were told they could not export beef to Japan because Japanese intestines were different. U.S. auto part exporters were told that the U.S. test data on reliability and performance could not be accepted in Japan because Japanese driving conditions were different.

I have always taken Japanese claims of uniqueness with a grain of salt. Usually they were simply excuses for protectionism. But now some of our most respected economists have come to the conclusion that Japan is in fact different. They agree that Japan is unique from the rest of the world in one important way. Namely, that Japan is far more closed to imports than other developed nations.

The President's Advisory Committee on Trade Policy and Negotiations recently issued a report that summarized the extensive evidence of Japan's uniqueness. Studies done at the Brookings Institute and the Institute for International Economics have concluded that Japan imports far less than one would expect for a developed nation. The problem is particularly severe for manufactured imports. In 1986 imports accounted for more than 37% of the manufactured products consumed in Germany, 27% of those consumed in France, and 14% of those consumed in the U.S. But in Japan, imports accounted for only about 4.4% of all manufactured products consumed. Even more strikingly, over the last decade the U.S. has imported almost 60% of the manufactured exports from developing nations. Japan has imported only about 5%.

As many observers have noted, Japan employs a web of informal trade barriers, such as distribution barriers, price fixing, and other collusive business arrangements, to exclude imports. The ACTPN concluded that these barriers could be depriving the U.S. of as much as $30 billion in exports each year.

The Japanese Economic Planning Agency (EPA)—a Japanese government agency—has released several interesting studies of these structural barriers. Several months ago, the EPA released a study that argued that the Japanese distribution system blocked imports. Just one month ago, the EPA released a study indicating that U.S. exporters were not the only victim of structural barriers The barriers also force Japanese consumers to pay 50% more for the same products as consumers elsewhere in the world. These EPA findings provide strong support for the U.S. view that the Japanese market is—to the detriment of Japanese consumers—largely closed to imports.

The situation has improved considerably in recent months. Japan has increased its imports. But Japan still lags far behind the rest of the developed world. Even in sectors where the U.S. has made great progress in opening the Japanese market, such as agriculture, informal barriers limit exports. For example, U.S. beef exports to Japan increased markedly in the year since the agreement was concluded to phase out the Japanese beef quota. But now I hear disturbing reports from Tokyo that the closed distribution system is keeping beef prices high and depriving Japanese consumers of low-cost, high-quality, imported beef.

As the beef experience demonstrates, until Japan eliminates these structural barriers, the U.S. will not eliminate the trade imbalance with Japan. This is not to say that the structural barriers are the only cause of the trade imbalance. Certainly, the U.S. also bears some of the blame. But there is no denying that Japanese structural barriers are blocking U.S. exports to Japan and forcing Japanese consumers to accept a lower living standard.

With this in mind, the U.S. government recently launched the Structural Impediments Initiative (SII). SII was conceived as a broad effort to eliminate Japanese structural barriers I strongly support the thrust of SII and have argued for several years that the Administration should launch a broad negotiation with Japan. This subcommittee has already held two hearings on the SII. Those hearings demonstrated broad consensus in the government and the private sector that Japanese structural barriers must be eliminated.

The purpose of today's subcommittee hearing is to further explore the U.S. strategy for addressing the trade problem with Japan. I an pleased that a number of representatives of the academic community have joined us to discuss the Japanese trade problem and outline their proposed solutions. Today's witnesses have some exciting and innovative ideas regarding the U.S. objectives in SII and U.S. trade policy toward Japan.

The debate over U.S. trade policy toward Japan increasingly centers on the issue of what type of trade agreement the U.S. should negotiate with Japan. Many argue that we can no longer negotiate agreements that focus only on establishing fair trading rules. Instead, we must begin to conclude agreements that guarantee results.

As several have pointed out, this issue bears a striking similarity to the debate over using affirmative action to remedy racial discrimination in this country. Given that discrimination against imports has been such a persistent problem in Japan, does affirmative action for imports make sense? In limited sectors where U.S. exports have been blocked by invisible trade barriers and where all else has failed, I believe it does.

But embarking on such a course is not without risk. Today's discussion will shed some light on these very complex issues as well as many others. I hope that the Administration takes note of the concepts discussed today, and incorporates them into the SII. I also hope that our Japanese friends take note of the wide consensus in the U.S. academic community that there is a serious U.S.-Japan trade problem.

## Prepared Statement of Pat Choate

Mr Chairman and Members of the Committee: I am pleased to have the opportunity to share with you some thoughts on bilateral trade relations with Japan, and particularly on the new Strategic Impediments Initiative. In fairness to you and my employer—TRW Inc.—I also want to point out that the views that I offer are my own and are not necessarily representative of the position of TRW or any other organization.

### A PASSION FOR PROCESS

The most striking feature of American trade negotiations with Japan is their sheer predictability. By now, we know in advance not only which issues will be discussed, but also the approaches that will be taken by both sides, and the results that will be achieved. Let me explain.

In August 1972, President Nixon met with Prime Minister Tanaka in Honolulu. The primary subject of this summit was the expanding American trade deficit with Japan—which that year had reached the unprecedented level of $3.8 billion.

In response to the deficit problem, President Nixon called on the Japanese to do a number of things.

- First, he urged them to reduce their non-tariff trade barriers.
- Then he asked the Japanese to buy more American-made computers. Other U.S. negotiators pressed the Japanese to buy American-made aircraft and satellites.
- President Nixon requested that the Japanese purchase more American agricultural products.
- He said the Japanese should eliminate barriers to the establishment or purchases of retail outlets in Japan by U.S. companies.
- And he called on the Japanese to liberalize their business distribution system.

In response, the Japanese Government promised to "try to promote imports from the United States and to reduce the imbalance in a more manageable size within a reasonable period of time." They figured that three or four years would constitute a "reasonable" time frame.

The final Nixon-Tanaka communique emphasized the Japanese Government's offer to improve its distribution system, to lower investment barriers for American retail firms, and to permit more sales of U.S. computer products in Japan. Specifically, the communique read:

> The President also noted with appreciation the recent decisions by the Government of Japan to liberalize access to the distribution system by allowing improved investment opportunities in retailing, processing, and packaging as well as the decision to allow greater sales of computer products in Japan.

In the end, both President Nixon and Prime Minister Tanaka affirmed "the commitments of both countries to initiate and actively support multilateral trade negotiations covering both industry and agriculture and the reduction of tariff and non-tariff barriers as well as formulation of a multilateral non-discriminatory safeguard mechanism."

On October 19, 1989, U.S. Trade Representative Carla Hills addressed the Japan National Press Club in Tokyo. Ambassador Hills' main concern was the massive U.S.-Japan trade deficit an unprecedented $50 billion. Her comments last month, while certainly timely, were also hauntingly familiar.

- Like President Nixon nearly twenty years before her, Ambassador Hills encouraged the Japanese to reduce their non-tariff barriers to American products.
- She called on them to lower barriers to the sales of U.S. satellites and supercomputers.
- She urged the Japanese to buy more American forest products.
- She told them the story of how the Japanese Government is keeping two of America's largest retailers Toys-R-Us and McDonald's from opening stores in Japan for two years while it deliberates on the firms' investment applications.
- And she asserted that Japan's closed distribution system hurts not only American producers by retarding U.S. exports to Japan, but also affects Japanese consumers, who are forced to pay higher prices for those goods.

In the end like President Nixon—Ambassador Hills reaffirmed America's commitment to the principles of free trade and the ongoing round of GATT negotiations.

The Nixon-Hills example is not unique. America seems to have a passion for process-oriented negotiations with Japan. Consider for a moment the following seven market-opening packages.

### PACKAGE ONE

On January 30, 1982, a Japanese ad-hoc committee led by former MITI Minister Esaki announced that the Japanese Government would reduce 67 non-tariff barriers—primarily in the customs and standards areas—as a package of market-opening measures. Japan established a new government-wide channel for foreign grievances called the Office of Trade Ombudsman, and Japanese Customs authorities announced a five-point plan to improve foreign access to the Japanese market.

Following the announcement of this market-opening package, the Office of the United States Trade Representative commented that the Japanese initiatives were not exactly what they appeared to be. "Upon analysis," reported the USTR's office, "it became clear that those 67 actions largely reflected a compilation of measures that had already been undertaken by various Japanese Government agencies."

### PACKAGE TWO

On May 27, 1982, the Japanese Government announced a second major market access package. Through this initiative, the Japanese said, they would reduce tariffs on 17 agricultural items, address problems with standards development, and allow foreigners to participate in Japanese technical groups of domestic industry organizations that were formed to draft specifications to submit to Japanese Government ministries. Despite heavy U.S. pressure, though, agricultural production liberalization was not included in this package.

### PACKAGE THREE

On January 13, 1983, Japan announced the reduction of tariff rates on 28 industrial and 47 agricultural products. This third market-opening package included a call for the simplification of import testing and certification procedures—including acceptance of certain test data generated overseas for veterinary drugs, feed additives, high-pressure containers and electrical appliances.

In addition, the Japanese Government promised import-promoting administrative reforms, as well as the expansion of the number of retail outlets allowed to handle imported tobacco products.

### PACKAGE FOUR

On October 21, 1983, the Japanese reduced tariff rates on 40 items. The Japanese Government also called upon its industries to import more foreign products.

### PACKAGE FIVE

On April 27, 1984, the Japanese Government announced that it would take several new steps to open Japanese markets to foreign products. Among the measures that were promised were the elimination of tariffs on seven items, and the reduction of tariff rates on 60 others. The package also included the liberalization of procurement rules on satellites purchased by Nippon Telephone and Telegraph, as well as those purchased in the private sector. The Japanese Government also accepted, through this package, the submission of test data from suitable foreign testing organizations to certify a range of products.

Most importantly, this fifth market-opening package included the Japanese Government's statement of intent to allow government agencies, government-related agencies *and private firms* the option of purchasing space satellites from foreign suppliers *in cases where purchases from a Japanese source is not necessary for the domestic development of technology.*

But in the spring of 1984, when the Japanese announced these initiatives, the U.S.-Japan Trade Study Group comprised of businessmen from both the United States and Japan—reported that many of the allegedly new undertakings had "been previously announced." The Reagan Administration called the proposed tariff changes "too little, too late," and asserted that many of the promises made by the Japanese Government were simply too vague.

### PACKAGE SIX

On April 9, 1985, Japan unveiled another package of market access initiatives. This time, the Japanese said, they would eliminate many of the technical standards used to select telecommunications terminal equipment. The Japanese Government also agreed to enforce procedural transparency in the telecommunications industry.

### PACKAGE SEVEN

On July 30, 1985, Japan announced an all-new "action program" for improving foreign access to its markets. At the center of this package was the Japanese Government's pledge to reform its standards and approval processes. This seventh package also outlined changes in tariffs, import quotas, government procurement, financial and capital markets, services and import promotion measures.

### MOSS

In addition to offering these seven market-opening measures, the Japanese government has been involved in a series of more specific, market-opening negotiations with the United States. The biggest of these talks was the January 2, 1985 Market-Oriented Sector Selective (MOSS) proposed by Japan. The 1985 talks focused on telecommunications, pharmaceuticals, medical equipment, electronics, and forestry products. A year later they were expanded to include auto parts.

### MAEKAWA REPORT

In October 1985, Prime Minister Nakasone formed an Advisory Group on Economic Structural Adjustment for International Harmony, chaired by Haruo Maekawa, former president of the Bank of Japan. The Maekawa Group issued its final report on April 7, 1986. It called for a major restructuring of the Japanese economy—an increase in imports of manufactured goods, tariff reductions, streamlined standards and certification procedures, and a simplified distribution system.

Yet, as we end the decade of the 1980's, and after all of these market-opening processes and vast expenditures on negotiations, the Japanese market remains only marginally more open than it was at the end of the 1970s.

Indeed, Tallyrand's observation about the Bourbons seems appropriate to us: That is, they forgot nothing, they learned nothing.

### PROCESS VERSUS RESULTS

The one clear lesson of U.S.-Japanese bilateral trade negotiations of the past two decades is that if process is what you want, process is what you will get. But what we *really need* is results.

In the final analysis, the difficulty lies not with Japan, but with us. American trade policies remain locked in the past. They sit on three theoretical pillars—none of which are appropriate for the circumstances in which we now find ourselves:

- First, that open markets and free trade are the most efficient means by which to expand global trade and, therefore, should form the economic model that guides world commerce.
- Second, that multilateral negotiations are the best way to open markets and promote free trade.
- And third, that the United States has a primary responsibility among nations to advance free trade.

The obvious flaw in our thinking is that Japan's economy is like ours. It is not. Nor will it be. Nor should it be. What's more, they keep telling us so, and we keep refusing to believe them.

Indeed, Japan operates in the world market using vastly different assumptions that serve vastly different ends from America's. Our two nations differ in ways both manifest and subtle, reflecting basic differences in history, culture, national aspirations and politics.

Despite America's spirited urging of Japan to adopt the U.S. economic model—reliance on market forces, free trade, and deregulation—this system enjoys little appeal across the Pacific. Sure, it suits us. But it would never fit Japan—and they know it.

Put another way, Japan has the world's largest accumulation of savings, is the world's largest creditor, has the world's most advanced commercial technology, possesses the world's most advanced manufacturing capacity. Japan also has one of the world's lowest unemployment rates and claims enormous social stability. Japan—with an economy half the size of ours—is investing at a rate twice as fast as the United States. Last year, in fact, Japan made more fixed capital investment than the United States and Canada combined, which means that its competitiveness and growth will surge in the 1990s. Japan has a $50 billion trade surplus with the United States, and the prospects for strong "net national profits" from trade surpluses for as long as one can calculate.

Why would Japan wish to abandon an economic system that serves its interests so well and adopt an approach that serves ours instead?

### A BOTTOM-LINE APPROACH

If the United States is to reduce its trade deficits with Japan, we require a strategy far different from those we have used in the past two decades.

Clearly, we must have trade-sensitive fiscal, monetary, and exchange-rate policies. And the government must enforce domestic trade laws vigorously. But beyond sound macroeconomic policies and the production of fully competitive goods and services, America also requires a strategy that focuses on securing bottom-line results in its trade negotiations.

While this can be achieved through a variety of means the goal must be results. We require a long-term negotiating strategy that will concentrate on outcomes, timetables and mutual responsibilities. We require agreement on levels of permissible trade imbalances, the composition of trade, allowable market shares, investment in both countries, and practices like dumping in third markets.

Access to America's markets for both imports and investments is the best—perhaps the only—negotiating chip the U.S. has. If we are unwilling to use it, we have no negotiating leverage. Indeed, if we are unwilling to use that leverage while keeping our markets open, why should anyone wish to do anything other than stall and delay negotiations?

To be sure, America must not succumb to the lure of old-fashioned protectionism. Rather, we must be sophisticated enough to discern the difference between closing U.S. markets to avoid foreign competition and closing them as a device to open Japan's markets.

And to be sure, we have permitted the fiscal and trade imbalance with Japan to go on so long that the process of adjustment guarantees that pain is inevitable on both sides of the Pacific. The only consolation is that the pain will be less horrible now than it will be if we wait even longer to take action.

In sum, therefore, I would respectfully suggest that, while the intentions of the SII effort are laudable, its prospects for reducing the trade imbalance are negligible at best. It is ad-hoc, and not a continuing effort. And I fear that, once again, we will get much process and few exports.

Thus, it seems appropriate for us to begin to devise a blueprint for a bottom-line approach to negotiations with Japan. We will need it next year. Thank you.

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## Prepared Statement of Rudiger Dornbusch

### THE STRUCTURAL IMPEDIMENTS INITIATIVE OR THE SECOND COMING OF GENERAL DOUGLAS MACARTHUR [1]

The Structural Impediments Initiative (SII) is yet another misdirected attempt to come to grips with the large US trade deficit and the closedness of the Japanese markets. Like previous initiatives, it creates expectations that cannot possibly be fulfilled, inappropriate mechanisms for the remedy of our trade problems and unproductive friction.

The US agenda in the SII discussions includes the Japanese distribution system, exclusive business practices, land use, antitrust enforcement and the Japanese savings and investment rates. On the Japanese side the agenda lists the US budget deficit, the short-term orientation of US business, education and training as well as productivity. It is no doubt a Japanese irony that their agenda would in fact eliminate the US deficit while our own is unlikely to make a dent.

In fact, nobody seriously believe that the US can or even plans make any commitments on the Japanese agenda points and accordingly not much will happen other than broad Japanese commitments to make some adjustments Whether these adjustments ultimately translate into significantly higher US exports is wide open to question. Certainly negotiations and adjustments in the past do not encourage any optimism.[2]

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[1] Testimony before the Subcommittee on International Trade of the Senate Finance Committee, November 7, 1989.

[2] In 1984 Treasury Secretary Regan told a Tokyo audience: "Your markets are not open . . . It's a message I have been delivering for three years now, and people have been saying to me: Patience, Patience. I'm about to run out of patience I've have had this now three and a half years How much more patience do you want. My response is: action, action, that's what I want

Continued

We should be serious and hardnosed about opening the Japanese market, but our negotiators are dead wrong to phrasing the issue in terms of bilateral trade balance or any notion of trade balance at all. We should also not fool ourselves into believing that we can succeed in restructuring the Japanese economy, the second richest in the world and our main creditor. If General MacArthur missed his chance in 1945, now it is too late.

We should concentrate on our objectives—results in terms of exports to Japan not on the mechanisms. In the trench warfare of adjustment debates the Japanese have shown their complete superiority in the past decade. We have come away embarrassed with the lack of success and embarrassed as noisy and ineffectual bullies. Moreover, as long as our budget imbalance and low saving rates persist, the trade deficit reflects predominantly our macroeconomic misalignment, not foreign restrictions. Japan skillfully plays this card and it provides an easy diversion from a serious discussion about market access in Japan.

We are seen as placing on other countries the blame for our inadequate performance and in the process fail to make our point that foreign market access is a legitimate concern. The US negotiators should learn to separate clearly two issues: One is adjustment of our external imbalance, which requires macroeconomic adjustment at home. The other is market access in Japan which is, indeed, seriously impeded and should be freed. 4n appropriate instrument for the latter is a result-oriented trade policy which sets multi-year targets for Japanese import growth combined with an automatic, across-the board-tariff surcharge if performance is inadequate. Such a policy places on Japan the burden to achieve our market access objective.

## TRADE IMPEDIMENTS AND TRADE IMBALANCE

The US trade deficits have unfortunately become central to the discussion of a more active trade policy. The focus is undesirable because trade policy should not be used to bring about trade balancing, and certainly not bilateral trade balancing.

The focus on bilateral imbalance which emerged from Congressman Gephardt's protectionist approach is altogether unfortunate. Bilateral balancing is a concept that originated in the 1930s in Hitler Germany; it was subsequently used in planned economies and was the rule for a while in the eastern blocks COMECON; it also was used in the immediate postwar period in Europe before the Marshall Plan and the European Payments Union brought multilateral approaches back. Bilateral balancing is so primitive an organization of international exchange that it is almost tantamount to barter trade. There is simply no excuse for such a focus and it is embarrassing that our administration perpetuates the use of this Schachtian notion in negotiations with Japan. It has no place in a market economy and even the Soviets have given it up.

And even if there were a sense to bilateral imbalances, it is hard to interpret the data in a way that suggests trade impediments abroad as a source of the imbalances. Table I shows the bilateral balances in 1980 and 1988. The bilateral imbalances with most foreign countries have grown in this period. Is this to suggest that all and everyone of them has erected new trade obstacles to US exports? And if our focus is on land use in Japan or business practices and distribution, have all these emerged as obstacles in the past few years? And what has happened in Germany and Canada to increase their bilateral surplus?

Table 1.—BILATERAL TRADE SURPLUS WITH THE US

[Billion $US]

| | 1980 | 1988 |
|---|---|---|
| World: | 19.5 | 119.8 |
| Japan | 10.1 | 52.1 |
| Germany | 0.9 | 12.2 |
| Italy | -1.1 | 4.8 |
| Canada | 0.7 | 10.6 |
| East Asian Nics | 3.0 | 28.4 |
| Mexico | −2.6 | 2.6 |

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now. I'm through with patience . . ." Quoted in J. Frankel *The Yen/Dollar Agreement* Institute for International Economics Policy Analyses in International Economics No. 9, Institute for international economics, Washington, D.C.).

The $100 billion deterioration of the US trade balance in the 1980s reflects domestic macroeconomic misalignment, not trade impediments. Our trading partners rightly question how we can possibly expect to achieve trade balance without macroeconomics correction. they rightly fear that any forced trade improvement would translate into inflation, higher interest rates, dollar appreciation and yet more commotion. Trade improvement at full employment must crowd out investment unless there is an increase in personal saving or a reduction in the budget deficit. Neither of these corrections is in sight although they are far more important for the national interest than Japanese practices in land use or antitrust.

Concretely, if Japan tomorrow decided to import an extra $50 billion from the US thus would represent a 1 percent increase in demand for US goods and services. Including moderate multiplier effects the increase in real demand would push the unemployment rate down by a full percentage point, well into the region of red hot overheating. Moreover in many industries there is not even enough excess capacity to respond to the demand increase and immediate increases in prices would result. The sharp increase in inflation, and the Federal Reserve response in the form of tight credit, would raise interest-rates, drive down investment spending and bring about further dollar appreciation. There is not even the expectation of a trade improvement.

The point is that the US trade balance reflects not only market access for US goods abroad, and for foreign goods at home, but above all national saving and investment. If there were today a sharp improvement in US market access abroad there is little doubt that exports would rise. But there are further effects that must be spelled out: the US is at full employment so that an increase in real demand for US goods must lead to crowding out. Increased exports would lead to higher real interest rates and hence reduced investment and they would lead to dollar appreciation and hence increased imports. It is not even clear whether the trade balance would improve At the risk of making a simple point, the trade balance will improve only if the *net* effect of market opening abroad (taking into consideration the adjustment of the entire world economy) is to raise US saving relative to investment or to improve the budget deficit. The national income identity helps see this point: Net Exports - Saving - Investment.

Japan saves more than it invests and accordingly there is a surplus in the external balance In the US saving is not only low but also lower than investment and accordingly there is an external deficit. Far from reflecting an investment boom, and hence future profits to service the growing external indebtedness, our deficits mirror a fall in private saving and large structural budget deficits.

Table 2.—SAVING AND INVESTMENT: 1983–87

[Percent of GNP, period average]

| | Saving | Investment |
|---|---|---|
| US | 15.7 | 17.7 |
| Japan | 31.3 | 26.1 |

It is conceivable that market access abroad could improve the trade balance—firms make more profits, they invest little and save more and they pay more in taxes which the government does not spend—but the outcome is not certain. This is all the more the case when the economy is substantially at full employment, as is the case in the US today, so that crowding out becomes inevitable. We might experience a trade improvement but it would carry with it a higher inflation, higher interest rates dollar appreciation, a worsening of the budget deficit and a fall in investment. It is very doubtful that we really can afford a trade improvement today without first undertaking a significant correction in the budget that frees the resources required.

## WHAT TRADE POLICY CAN ACHIEVE

Trade policy properly is directed to the standard of living not the trade balance. If the US enjoys open markets abroad and allows unimpeded access at home the real income of Us workers is maximized. Buy contrast, if foreign markets are protected and the home market is closed to low cost imports real income of US workers is reduced.

In a fully employed economy with suitable adjustment assistance there need not be any concern about trade opening. Extra exports require resources for their production and they will naturally come from a reduced employment in import competing industries. the net result of successful trade policy thus is good jobs at good wages. There is plenty of room for active trade policy: our own market is not as open as we make ourselves believe. There are especially pervasive restrictions on goods of interest to developing countries and in automobiles and semiconductors our trade restraints (or their aftermath) continue to restrict imports. Foreign markets remain closed in many cases. This is especially true of most developing countries and, of course, of Japan.

US trade policy should seek to roll back the increasing protectionism through nontariff barriers at home and to secure broader market opening abroad. The Uruguay Round offers one approach, although it need not be the exclusive vehicle. On the contrary, a multi-track approach would enhance the credibility of a US commitment to achieve more open markets abroad. Opening these markets provides opportunities for raising our real income. As noted above, however, market opening also poses an adjustment problem. Either the opening must be accompanied by increased saving or else by trade liberalization at home.

## THE JAPAN PROBLEM

Perhaps the most striking failure of the GATT system is the continuing closedness of the Japanese market. Although the country did participate in the various rounds of tariff cutting, the Japanese economy remains basically closed in manufactures trade and, of course, in agriculture. Tariff protection (or explicit quotas) are not at issue as Table 3 shows. In fact, Japan seems somewhat of an onion with multiple layers of protection of one kind or another. As a result, a market as large as one-fifth of industrialized countries (See Figure 1) effectively remains closed today.

Table 3.—POST-KENNEDY ROUND TARIFF RATES

[Percent]

| | Raw Materials | Semi-Finished Manufactures | Finished Manufactures |
|---|---|---|---|
| US | 1.8 | 6.1 | 7.0 |
| Japan | 1.4 | 6.3 | 6.4 |
| Canada | 2.6 | 6.6 | 8.1 |
| EEC | 1.6 | 6.2 | 7.0 |

Source: GATT.

The finding that Japan remains a closed economy is based on the trendless, low level of import penetration in manufacturing. This is shown in Table 4 as well as in figure 2. Whereas all industrialized countries show major increases in import penetration, for Japan the extent is smaller than everywhere else and shows no sign of rising over the past decade.

Table 4.—IMPORT PENETRATION IN MANUFACTURING

[Percent of Apparent Consumption of Manufactures]

| | 1975 | 1980 | 1985 |
|---|---|---|---|
| Canada | 19.5 | 30.6 | 38.7 |
| Germany | 22.9 | 27.7 | 31.7 |
| UK | 14.2 | 25.3 | 33.2 |
| US | 5.5 | 93 | 12.9 |
| Japan | 4.7 | 5.8 | 5.3 |

Source: OECD "The OECD Compatible Trade and Production Data Base: 1970–85." Paris, mimeo, 1988.

Three explanations have been offered traditionally. One is that Japan as a resource poor country is an exporter of manufactures and an importer of materials. That argument is entirely correct and would lead us to expect that the manufacturing content of exports should be far higher than that of imports. But clearly resource endowments are not the only source of trade, there is also intra-industry trade based on gains from variety. For all industrialized countries other than Japan much of the increase in import penetration reflects precisely this channel whereas in Japan it is virtually absent. Resource endowments then cannot be the explanation.

The alternative argument is that government non-tariff barriers stand in the way of imports. That has clearly been the case for public procurement and more generally for anything that required facilitating regulation. But more important is probably the third reason which goes under the heading of "culture" and as such seems almost acceptable, Japanese consumers and firms "prefer" Japanese goods.

A striking piece of evidence of this effect has been brought by Max Kreinin who reports on a survey of capital goods purchases by multinational firms located in Australia. Whereas European and US multinationals purchase their capital goods anywhere in the world, based on price and quality, Japanese firms buy their capital goods virtually without exception in Japan! Japanese firms might purchase a relatively larger or even very large share of their capital goods in Japan, but the exclusive purchase in Japan draws attention.

The mechanisms of the buy-Japanese attitude are diffuse. They range from familiarity and ease of business relations, inertia, a taste for discrimination to the social pressures applied to deviant behavior by a business community which practices a redlining policy against imports.

It does make a difference whether low import penetration is a reflection of a taste for discrimination or whether it is mostly the outcome of a government and business policy of trade restriction. In the former case one can take one of two views: one is that one cannot argue with tastes If Japanese consumers are willing to forego variety or pay more for made-in-Japan labels, so be it even if it comes at a terms of trade cost to the rest of the world.

The alternative is to take the position that in an open world society discrimination is a bad habit (taste), a reflection of ignorance, that should be rooted out by price and non-price measures. In this perspective import subsidies in Japan and import performance criteria would be the right response. If tastes is not the main reason, leaving the range from ignorance and inexperience to business-government conspiracy as the principal source of low import penetration, there can be no reason to accept the state of affairs and trade policy should remedy the problem in an effective manner. In fact, it does not really matter for our purposes what causes Japan's imports to be low.

## TRADE POLICY TOWARD JAPAN

Import discrimination in Japan is a fact and the cost of protection to Japanese consumers is their own problem. But their discrimination hurts our export firms and that is unacceptable in an open grading system.

Rather than focussing on the SII mechanism, which like the previous MOSS talks, will do little measurable good, the US should develop a results-oriented trade policy toward Japan. Results-oriented policy means that actual exports to Japan over the next decade, rather than elusive discussions of the means and ends, become the focus of policy. Specifically, a target should be set for the growth rates of Japanese imports of US manufactures. Over the next decade, monitored on 3 year moving averages Japanese manufactures imports from US should grow at an average (inflation adjusted) rate of 15 percent per. year. [3] Over the reference period, assuming a 5 percent growth of apparent consumption, the share met by US supplies would rise from about 2.5 percent today to 6 percent of Japanese apparent consumption of manufactures. In terms of Japanese CNP, the import share of US manufactures would rise from 0.7 percent to 1.7 percent.

There ought to be an effective sanction mechanism, automatic and forceful enough to initiate a timely and complete Japanese understanding that adjustment is required and this involves inevitably restrictions on Japanese market access in the US. There are two possible routes. One is to maximize the disruptive effects for Japan and minimize the costs to US consumers. This objective could be served by developing a list of commodities for which substitute producers could easily and rapidly replace Japanese shipments. The alternative is to use across the board tariff surcharges on Japanese imports, triggered automatically and proportionate to the shortfall of Japanese import growth. This latter mechanism has the attraction of minimizing the political intervention and fall out and is therefore highly preferable.

It is clear that such a policy raises any number of issues. The first question is whether Japan would simply shift demand from European to US goods, and if so what would be the European response to Japan and to the US? And what if Europe made the same demands of Japan? Here the answer seems straight forward: one would hope that Europe would make the same demand and (in exchange) forego the growing tendency to discriminate against Japanese goods. If so Japan is effectively faced with a multilateral challenge to open which, if met, will lead to freer trade.

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[3] In 1987 Japan imported $55 billion of manufactures of which $16.3 came or the US. Japanese GNP in 1987 was about $2366 billion. Over the period 1985–88 the average growth of US manufactures exports to Japan was 21.1 percent.

Next in line is the issue whether Japanese firms might become the vehicles for implementing the policy challenge. They would locate in the US to produce "Japanese" goods for sale in Japan. There is no problem with Japanese investment in the US, what is of interest is US located production and value added and if Japanese firms are better at providing the employment, so be it. Whether the employer is a US or Japanese firm is almost entirely irrelevant. Of course, it must be understood that the trade growth results have to be substantially based on US value added rather than accounting trade.

Third is the possibility that Japan considers the US posture unacceptable and threatens to trigger the sanction. The concern here is he spreading of economic questions to wider foreign policy and national security concerns. It would be an illusion to think that these issues are not in fact on the surface and in need of an answer. Japan has grown up and is looking to define a role commensurate with her economic strength. It is as well to trigger the search for that identity and let Japan choose whether she is willing to be part of an open trading system of OECD countries or look for another role. Japan does have alternatives—increased integration in Asia and possibly even with the Soviet Union.[4] It would be a mistake to postpone the policy challenge because, as these alternatives are being developed today, the effectiveness of sanctions in the future is much less.

Finally, an effective market opening of Japan will free resources in Japan and one must ask how the adjustment will take place. One possibility is that the real income gains in Japan raise total demand. Another possibility is that resources made redundant by import competition are absorbed in the export sector and thus increase Japan's export competitiveness. There is no problem in this; the US policy objective should be to open markets, not to defend against cheap imports that raise our standard of living.

The state of siege mentality that shapes our trade policy is a reflection of our vulnerability as an economy and as a world leader. It stems from our persistent structural problems. To remedy these is the most urgent priority.

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[4] I have explored these in an editorial in the Washington Post, National Weekly Edition, July 24–30, 1989.

FIGURE 1

JAPAN: IMPORT GNP RATIOS

(PERCENT OF GNP)

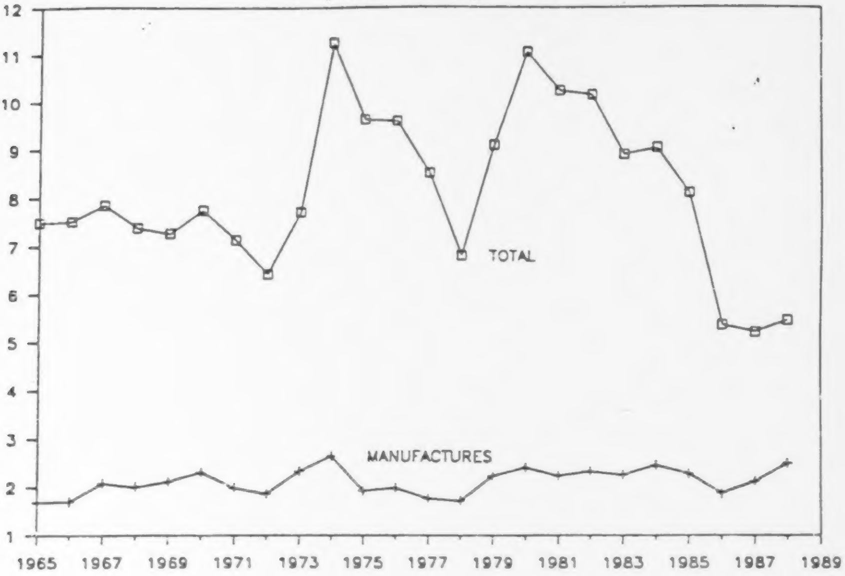
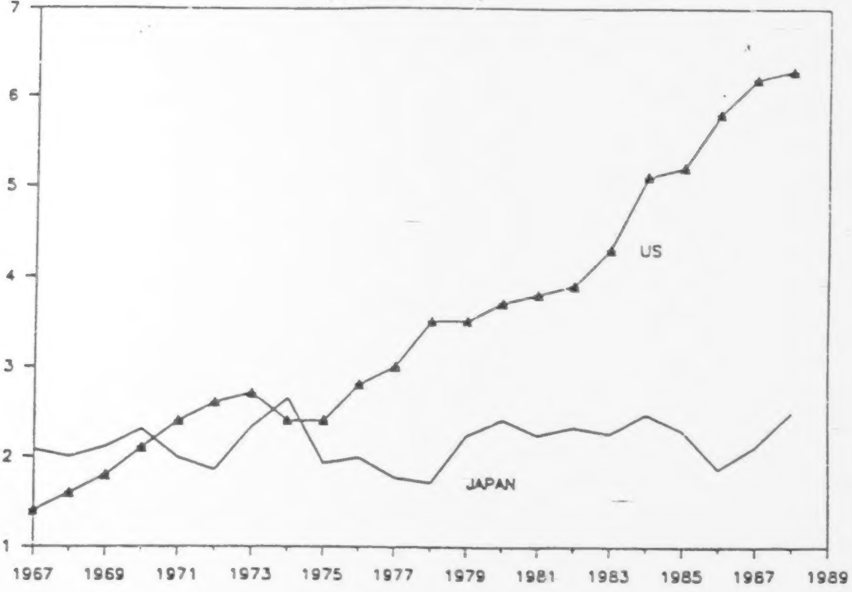


FIGURE 2

MANUFACTURES IMPORTS

(PERCENT OF GNP)



## PREPARED STATEMENT OF MITCHELL E. KERTZMAN

This subcommittee is to be commended for holding hearings on the Structural Impediments Initiative (SII). Our commercial imbalance with Japan is a cancer eating away at the health of the international trading system, and at the health of the U.S. industrial base.

Reversing this unacceptable trade imbalance will require action by the U.S., as well as by Japan. We applaud your close attention to these discussions as Congress will have to work closely with the Administration in implementing U.S. action.

The American Electronics Association is pleased to have the opportunity, on behalf of its members, to submit testimony regarding these structural impediments talks. AEA represents over 3500 electronics firms from all over our nation in all segments of electronics, including components, computers, telecommunications, and software. The U.S. electronics industry is one of the fastest growing sectors in the U.S. economy. It employs some 2.5 million workers, more than autos or steel. Products produced by our industry are vital to our national security, and critical to the growth of many other sectors of our economy. In fact, electronics is so important that many nations have targeted this sector for concerted national efforts to gain global market share.

While our industry is generally healthy, we are deeply concerned with the longer-term trends. Our global market share in many segments is shrinking rapidly. For example, in radio and radar, we dropped from 68.8% in 1984 to 59% today. In instruments, we dropped from 56.7% to 43.9%. Trends in medical equipment, components, data processing, semiconductors, and telecommunications are similar (see the attached table). And most of this market share loss has been to Japan.

Our electronics trade deficit with Japan has been increasing, and reached $22.4 billion in 1988. Looking at trends of imports and exports in the electronics area, this deficit could grow to $39.7 billion by 1993.[1] As you can see from the attached chart, this imbalance has increased even though the dollar has depreciated dramatically against the yen. It is noteworthy that due to the currency changes of recent years, our trade posture improved dramatically with all other countries except Japan.

We believe it is also extremely significant that our trade balance continues to deteriorate despite the numerous trade agreements in electronics that have been entered into between the U.S. and Japan. Between 1979 and 1989 there have been a total of 15 agreements related to electronics trade and market access issues between the U.S. and Japan.[2] These include agreements with NTT, a high tech agreement, an agreement on semiconductors, an agreement on supercomputers, an understanding on communications satellites, the MOSS talks on electronics, medical equipment and telecommunications, supercomputers, and the science and technology agreement. Clearly, individual agreements without a comprehensive strategy for monitoring and implementation will not be successful.

U.S.-Japan trade problems are complex and not well understood. To a great extent they stem from the differing socioeconomic systems in the two countries. Because the imbalances are largely caused by differing socioeconomic systems, we applaud the approach taken by the SII which puts the discussion clearly where it belongs—on solving the trade imbalance. And not on a discussion of fair or unfair trade.

We concur with the Administration's decision not to treat structural adjustment as an unfair trade practice under the Super 301 umbrella. While Japan's system should not be regarded as an unfair trade barrier, it is clearly doing damage to U.S. industry and their attempts to penetrate the Japanese market. These talks should also seek to address the impact of structural adjustment on bilateral investment. We believe that unless these structural problems are addressed in a comprehensive fashion, the future health of our industry is threatened, as is the very survival of the GATT trading system. It is extremely important that we work with Japan to address all these issues.

Among the categories identified for discussion under SII, the key impediments facing U.S. electronics firms trying to sell in the Japanese market fall under the category of exclusionary business practices. This category includes government procurement, intellectual property protection, toleration of anti-competitive practices and buy national attitudes.

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[1] "The U.S.-Japan Bilateral Electronics Trade Deficit: 1989–1993," Quick, Finan & Associates, Washington, DC., June 1989, p. i.

[2] "Report to the American Electronics Association on Past Agreements Related to Electronics Reached between the Government of the United States and the Government of Japan," Quick, Finan, & Associates, Washington, DC., May 1989.

A very significant obstacle to U.S. sales in the Japanese market has been an inability to penetrate the government procurement market in Japan. Even in the NTT market, where we have a trade agreement, our share is only 3.75%. Although foreign computer manufacturers have been quite successful in their penetration of the Japanese private sector, they have had only negligible sales to the public sector. Foreign computer manufacturers' share of the Japanese public sector is 5.8% as opposed to a 36.4% share of the commercial sector.

An example of the result of Japan's government programs and private anti-competitive behavior is the semiconductor industry. The foreign share of Japan's semiconductor market has consistently remained at 10% despite changes in the exchange rate and greatly intensified efforts by U.S. manufacturers to penetrate the Japanese market. One reason is that huge vertically integrated firms that both produce and consume semiconductors represent a large portion of the semiconductor market in Japan. Additionally, other major users, such as the automobile industry, are generally unwilling to purchase from non-Japanese sources. For example, the U.S. supplies about 60 to 70 percent of the automotive industry's need for semiconductors outside of Japan. In Japanese auto companies worldwide, however, our market share is only 1 percent.

The Administration has indicated their intention to continue vigorously pressing for enforcement of the semiconductor agreement under the current 301. We strongly support this. In fact, Japan is now the world's largest market for semiconductors, and full access to that market is critical.

Despite an 80 percent share of the world supercomputer market, U.S. manufacturers have not been able to penetrate the public sector supercomputer market. The U.S. sold its first supercomputer in the Japanese private market in 1979, and has installed 16 out of a total 150 supercomputers that have been sold in the Japanese market to date. Japan is the world's second largest supercomputer market with $1.5 billion in purchases through 1988. Forty percent of the market is publicly funded. The Japanese Government did not procure any supercomputers until Japanese companies developed their own supercomputers. To date, no U.S. supercomputers have been sold to the Japanese Government as a result of a competitive bid. The only two purchases of U.S. supercomputers by Japanese Government entities were done on a noncompetitive basis under a special, one-time only, 1987 import promotion budget.

In August 1987, the U.S. and Japan negotiated the Supercomputer Procurement Agreement, which called for a transparent, nondiscriminatory, procurement process. The first formal review of the agreement in October 1988 found U.S. companies face severe obstacles; no U.S. sales have been made or are expected in the near term under the new procedures.

In 1983 the Japanese Government articulated a goal of developing a domestic satellite and associated launch service industry. The policy developed to reach this goal included a prohibition against procuring foreign satellites. In response to U.S. concerns, Japan has specified that private entities may purchase foreign satellites. Despite NTT's privatization in 1985, it is precluded from buying foreign satellites until 1992. U.S. satellite manufacturers have been able to participate in the Japanese Government satellite market only as subcontractors to a Japanese manufacturer. Since satellites can often have R&D as well as commercial uses, one area of concern for U.S. manufacturers is Japan's definition of what constitutes a research satellite, and the belief that the Japanese government may fund all or part of satellites that are primarily for commercial use.

A special area of concern for electronics companies is that of intellectual property protection. Japan has one of the longest average periods of patent pendency in the developed world. U.S. companies have waited up to twelve years to obtain a patent, at which point their technology is often obsolete. We are also concerned about the practice of patent flooding in which large numbers of applications are filed to cover trivial changes in known technology, the extremely narrow scope allowed for claims, compulsory licensing, and the practice of coercive cross-licensing.

Another key problem facing U.S. companies in Japan is a business structure where Japanese firms in the same "keiretsu" have preferential purchasing arrangements with one another. Several U.S. companies have been in situations where their Japanese customers are in the same keiretsu group as the competing Japanese manufacturers. Typically, the Japanese customers elect to purchase inferior equipment made in the same keiretsu rather than more advanced equipment made by an American manufacturer.

We are supportive of the steps that the Administration has taken to deal with these issues facing the U.S. and Japan. We believe that the U.S. and Japan need to work together to forge a new trading system. We must take the differing socioeconomic systems in each country and craft a new trading relationship that will allow each country's companies to compete equitably and fairly in each other's country.

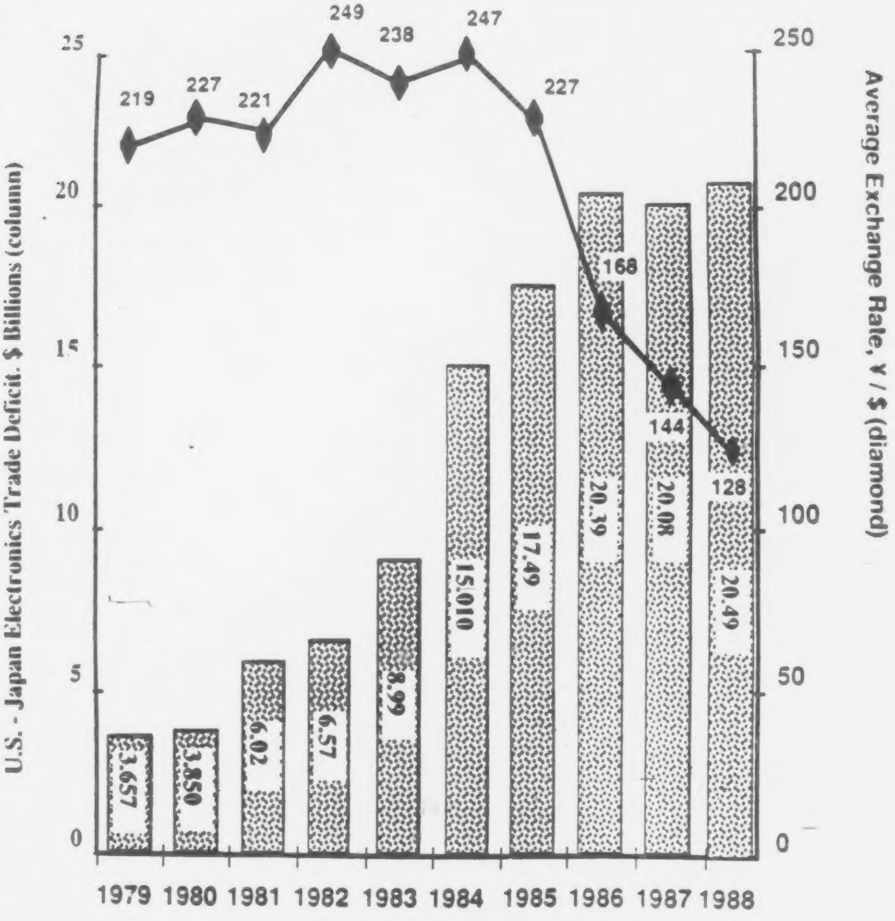
It is important that we recognize that many of the structural adjustment problems are our own responsibility. Frankly, it is our hope that our Japanese friends will press the U.S. Government to deal with its own economic problems that impact the bilateral trading relationship. High among these problems is the high cost of capital driven by our enormous budget deficit and our tax system which favors consumption over savings and investment. One by product of the low savings rate in the U.S. is that the amount of money raised from the sale of stock has been shrinking for the past three years. In the first three years of 1989, Japanese corporations raised more than $110 billion as compared with $20 billion by American companies—the largest gap ever between the two countries. Also important is our government's insufficient emphasis on trade promotion.

AEA will make every effort to support the government's structural adjustment talks. We have established a Japan Task Force through which we will work with the U.S. Government and our Japanese colleagues to solve the bilateral problems facing both our countries. In addition, AEA recently had a successful meeting with the Electronics Industry Association of Japan at which we expressed our concerns regarding the structural impediments to trade facing our members.

We hope that this committee will continue its oversight of the SII process. AEA is anxious to work with the Administration and the Congress to remove structural impediments in the U.S. and to vigorously pursue eliminating impediments facing U.S. electronics companies in Japan.

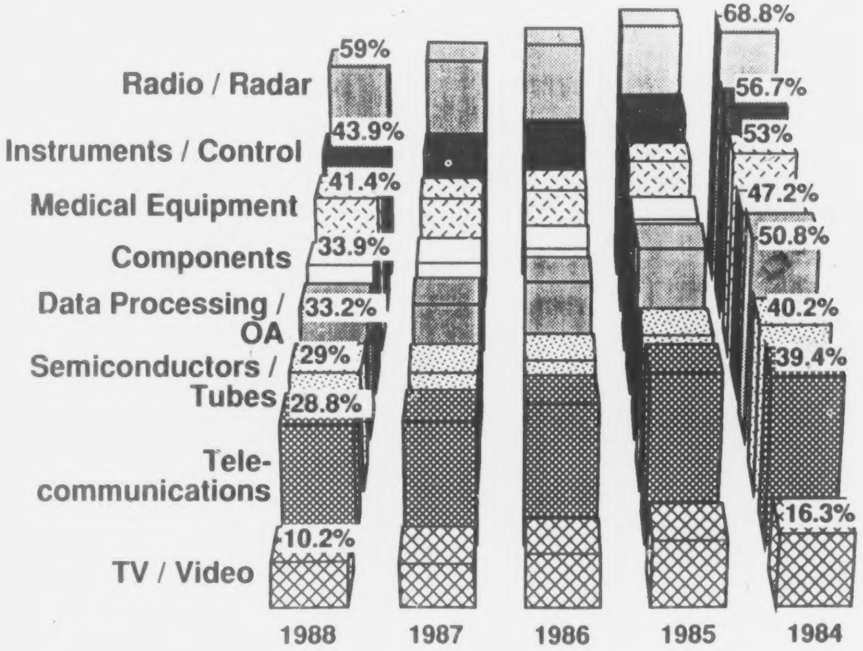
Attachment.

## U.S. - Japan Electronics Trade Deficit vs. The Yen



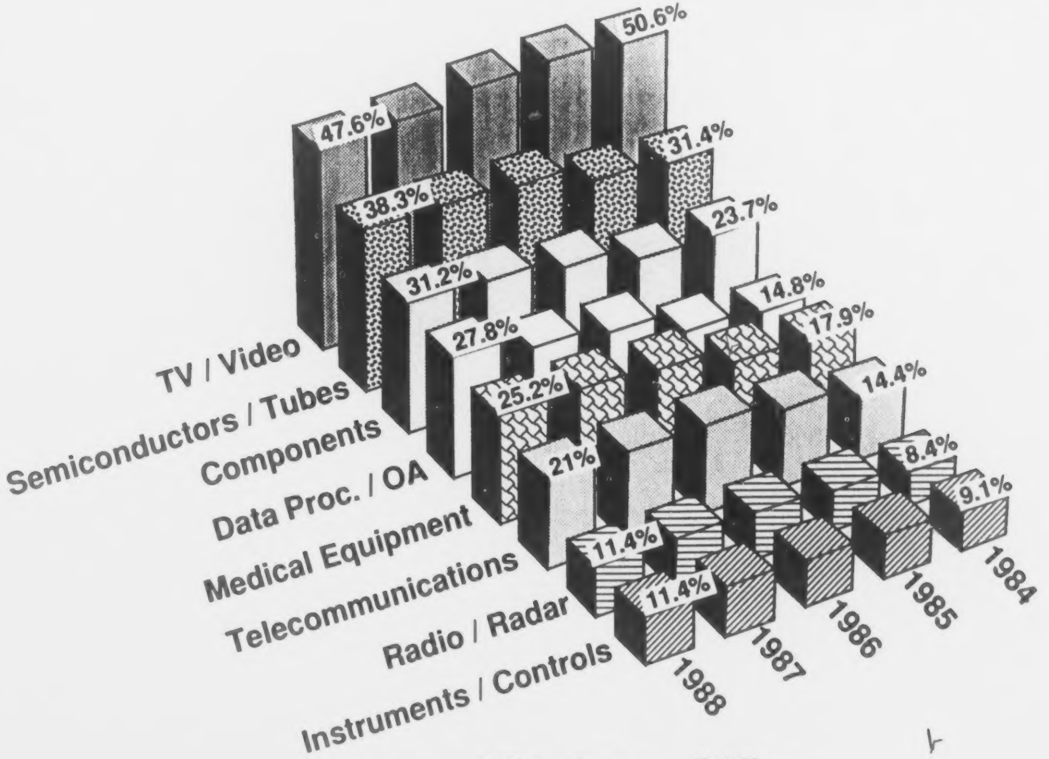
**AEA Japan Office**

# World Electronics : America's Shrinking Share



AEA Japan Office

## World Electronics : Japan's Growing Share



AEA Japan Office

## Prepared Statement of Robert Z. Lawrence*

It is a pleasure to be able to provide this committee with my views on the Structural Impediments Initiative (SII), the latest in the long line of negotiations between the United States and Japan which focus on the bilateral trade problems between our nations.

### WHY SII IS NEEDED

There is evidence that imported products face unusually large barriers in the Japanese market. In the case of agriculture, it is clear that formal quotas and tariffs protect Japanese farmers. In the case of manufactured goods, the barriers are informal and their existence must be inferred from the unusual features of Japanese trade structure and price behavior.

Japanese imports of manufactured products are an usually low share of Japanese consumption. This low level of imports is undoubtedly influenced by the great distance between Japan and its trading partners (physically and culturally), the relatively poor Japanese endowments of natural resources and the high quality of Japanese products. But barriers of other types are also important.

Compared with other countries, Japan engages in an usually low level of intraindustry trade. In Japan products are either exported or imported. Other industrial countries have far more mutual interpretation of markets.

Foreign investment levels in Japan are extraordinarily low for a country of its size. U.S. assets in Japan are roughly equal to levels in Australia, New Zealand and South Africa combined.

Prices of goods are much higher in Japan than in most other countries. A useful summary measure of goods prices in general is the purchasing power parity estimates used by the OECD for deflating measures of inventories (of both consumer and producer goods). In 1985, even when the yen was weak, goods prices in Japan were 25 percent higher than in the United States and 42 higher than in the European Community. In 1987, when the yen was stronger goods prices in Japan in 1987 were *85.6* percent higher than in the United States.

In a recent study, I analyzed distribution margins using input-output tables in Japan and the United States. I found that in both countries payments to the retail and wholesale trade sectors account for around a third of total value of final sales. This suggests the high prices in Japan are enjoyed by manufacturers rather than distributors. Indeed the different behavior of Japanese export and domestic prices points to the capacity of *producers* for international price discrimination. Apparently, Japanese producers are able to maintain prices at levels which are higher in Japan than elsewhere. This confirms in the aggregate, what many Japanese tourists have discovered. Japanese goods cost less in other countries than they do in Japan.

While distribution margins on products, in Japan, in general appear similar to those in the United States, this does not hold for margins on imported products. As reported in a survey conducted by the Ministry of Trade and Industry, the prices of imported brand name goods in Japan are 30–60 percent higher than those in the USA and Europe.

Finally there is important evidence from the patterns of corporate involvement in international trade. When America ships its exports to Europe, the shipments are made mainly by U.S. companies to a buyer in Europe. Similarly when Europe sells to the United States, the shipments are made by European companies to buyers in the U.S. But when the U.S. exports to Japan, most of the shipments are made by *Japanese* companies who buy or produce the goods in the U.S. This behavior results from the domestic market power which induces Japanese firms to move *downstream* through international backward vertical integration. Japanese firms control an unusually high share of Japanese trade because entry for foreign firms and products has been so difficult.

In sum, these data support the anecdotal evidence that monopolistic practices in Japan restrict new entrants, thereby allowing domestic firms to charge higher prices. If prices for the same products are higher in Japan than the rest of the world, barriers preventing arbitrage must exist. This suggests scope for policies to remove these barriers.

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* The responsibility for this statement is mine alone and does not reflect the views of the Brookings Institution, its officers, trustees, or other staff members.

## THE GOALS OF SII

The goals of the structural impediments initiative (SII) are worthwhile. These are to raise living standards in both Japan and the United States by opening the Japanese marketplace. If impediments to imports were lower in Japan, Japanese living standards would improve because consumers would be able to buy less expensive imports. Living standards in the U.S. would also benefit because we would sell more exports without having to reduce the value of the dollar.

While the goals of the initiative are admirable, I am concerned, however, about three aspects of the current $11 discussions.

The first concerns its relationship to the trade deficit. It is common to read statements by U.S. and Japanese officials which suggest that if the SII makes it easier for Americans to sell and invest in Japan, our bilateral trade deficit with Japan will automatically be reduced. But except in the very short run, this will not be the case.

One topic for both sides in the SII talks, the issue of savings and investment behavior in the two countries, does have obvious implications for the *aggregate* trade balance in goods and services of the two countries. The American trade balance is not principally determined by trade policy but by the balance between out saving and investment. The current account is by definition the difference between aggregate saving and investment. If Japan lowers its national saving rate relative to its domestic investment levels, its trade surplus in goods and services will decline. Similarly if the U.S. cuts its budget deficit and raises its national saving rate relative to domestic investment, our trade deficit will decline.

But the other topics initiated by the U.S. aim at making Japanese markets more open. And there is no necessary relationship between the size of a nation's trade balance and the openness of its markets. West Germany, for example, has one of world's most open markets, but in 1988, as a share of GNP, its trade surplus was almost twice that of Japan. Of course, even if it does not affect the overall trade balance, the goal of the SII is worthwhile. A more open Japanese market would result in greater volumes of trade and in improved world resource allocation. But there is a danger that by concentrating on the trade balance data, we will ignore the more important evidence, given by Japanese import and price behavior on whether or not this initiative has achieved its goals.

The second concerns the groundwork for these talks. While it is useful that both sides are making demands of each other, the talks will only succeed if both parties are convinced they have desirable objectives. It seems to me that prior to engaging in detail discussions about specific barriers, the U.S. and Japan should *jointly* outline a vision of the type of interaction we would like to see between our two countries over the long run. I believe we should commit ourselves to the goal of a barrier-free market by the year 2000 or 2010. We should then jointly decide what kinds of issues would have to be resolved to achieve this objective in much the same way as the European Economies laid out a blueprint for their 1992 initiative. Indeed, instead of telling each country telling the other what is wrong with their country, it would be illuminating to have each country detail its own shortcomings. I am sure, in the case of the U.S. our list would not be very different from the Japanese.

The Maekawa report has already laid out a vision of an open Japan and the MITI in Japan has engaged in similar exercises. The object of such an exercise would be to get agreement on the kind of economic system we both want. If we are unable to get such an agreement, there is no purpose served by getting bogged down in the details.

The third concern I have relates to time frame. We must ensure that SII not stand for a Super Impatient Initiative. Increasingly there is a recognition that economic interdependence between nations has grown to the point where we can no longer limit our concerns to border barriers. There is a need to resolve much deeper structural problems. Commitments to deal with the questions could be made relatively quickly. But given the deeply structural nature of the issues, the complete implementation will take many years. There is a danger that policymakers will try, as they have in the past, for a quick fix. There will be political pressures to declare problems have been solved, when in fact they have not been.

Unfortunately, to resolve many of these questions there is no substitute for discussion about the details. The issues dealt with at a general level in these talks might have to be supplemented by a more detailed sectoral focus. This requires an immense commitment of resources by both nations.

## WHAT IF SII FAILS?

*Alternative approaches.* Increasingly, there are calls for the U.S. to shift its demands from equal opportunity to affirmative action. Some argue Japan will never play by Western rules. Indeed given the outstanding performance of the Japanese economy, the outside world has no right to demand that Japan change practices which have served it so well. Instead of trying to change Japan, the outside world should simply negotiate quantitative import targets and allow the Japanese Government, which best understands its economic system, to ensure these are attained. The new slogan is therefore "results rather than rules." If the SII talks fail, or if political pressures mount, there is a danger U.S. policies will shift towards these managed trade solutions.

Some are calling for targets for aggregate Japanese imports of manufactured goods from the United States. Others advocate a more detailed sectoral approach to setting import levels. Advocates of a results-oriented approach to Japanese trade generally agree a managed trade system is not ideal, they suggest there is no other way to deal with Japan.

But while a results-oriented approach might raise the volume of Japanese trade, it could actually lead to a market with *more* rather than less government and corporate control. In fact, such an approach gives up on the idea the Japanese economy will ever be genuinely open. It settles for making sure that at least Japan buys a certain amount of imports as a quid pro quo for its exports. By insisting Japan implement such a system, the U.S. would severely limit Japan's ability to become a genuinely liberal economy. Sector-by-sector targets can only be enforced if the MITI (Ministry of Trade and Industry) is powerful enough to guide Japanese firm behavior in great detail. MITI would be forced to organize and monitor numerous buying cartels. Firms would be forced to collude on how imported products are to be handled. Instead of encouraging Japan in the liberal direction urged in its own official Maekawa report, the policies would be driving it back towards precisely the system the world finds so difficult in the first place.

It is hard to see why Americans will prefer a system of competition between bureaucrats over a system of competition between firms. Our governmental system is ill-suited to such a contest, and we are likely to do worse under it, than we do under the current system.

The U.S.-Japan Semiconducter Agreement is an example of results-oriented trade policy. It is striking that the side letter to the Semiconductor Trade Agreement (STA) negotiated between the United States and Japan called for the products of *foreign-owned* companies to achieve 20 percent of the domestic sales by 1991. The semiconducters which Texas Instruments produces in Japan or Korea, using Japanese and Korean workers, qualify for this quota, the semiconducters NEC or Fujitsu produce in the United States using American workers do not. As it has been implemented, this initiative is certainly not designed to maximize its impact on the U.S. industrial base. Indeed it could be met by the supply of semiconductors from Japan-based foreign owned firms! It is an example, of how managed trade can be captured by corporate interests, rather than interests representing US. consumers and workers generally.

Let me conclude by noting that we should not look upon our policies of using exchange rates and rules-oriented approaches as a failure. The progress may have been slower than many would like, but it is clear in the data. Since 1985, the Japanese economy has made major adjustments. In fact, many of the barriers to the Japanese market operate like tariffs rather than quotas. They keep imported products expensive in Japan but they do not prevent marginal responses to price and cost incentives. The result has been that as the Yen has appreciated, there has been a dramatic increase in the volume of manufactured goods imports into Japan over the past four years. The share of Japanese imports accounted for by the intra-firm shipments of Japanese-owned firms abroad has been declining and the share of U.S. exports to Japan shipped by U.S. firms increased from 11.3 percent in 1980 to 17 percent in 1987. Those who claim exchange rates do not change Japanese buying patterns, have simply not examined the data.

It is also noteworthy that U.S. exports have surged in sectors in which negotiations to change the rules have been concluded. According to the ACTPN Report to Mrs. Hills, after ten years of pressure, virtually all barriers to the importation of tobacco into Japan have fallen. The four sectors which were singled out for negotiation under the maligned Market Opening Sector Specific (MOSS) talks in the mid-1980's have shown impressive growth in Japanese imports. According to the report, from 1985 to 1987, U.S. exports to Japan in the four product categories combined increased by 46.5 percent, well above the 24.8 percent increase in total U.S. exports to Japan over the same period. The report dismisses this performance because the total increase in exports of the products (of $1.3 billion) was small relative to the entire bilateral trade imbalance. But no one expected negotiations in a few sectors to turn the entire imbalance around. The problem, may not be the approach, i.e., emphasizing rules, but the limited resources and narrow focus of the number of sectors brought into consideration. We need not only tough, persistent negotiations, but enough patience to let the results begin to build.

This testimony has been concerned quite properly with Japan. But the U.S. is primarily responsible for its trade deficit. If we had moved promptly to deal with our key problem—the U.S. budget deficit—we could indeed be impatient with Japan. But when we see the political problems posed for us by the relatively easy measures of raising enough tax money to finance our spending, we should understand the problems the Japanese face in making changes that go to the heart of their culture and way of life.

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## PREPARED STATEMENT OF DAVID D. LELAND

### BARRIERS TO THE JAPANESE WOOD PRODUCTS MARKET AND THE STRUCTURAL IMPEDIMENTS INITIATIVE

My name is Dave Leland, I am President of PlumCreek Timber Co. and a member of the Steering Committee of the National Forest Products Association's Alliance for Wood Products Exports. Thank you for permitting me to appear today to discuss the importance of the Structural Impediments Initiative to the U.S. wood products industry. In addition, I would like to discuss briefly the relationship of the SII with the Super 301 process, in which market access to Japan's wood products market has been designated a trade liberalization priority.

As many of the Members of this Committee know, the U.S. wood products industry is internationally competitive in both price and quality. On a unit cost basis, our costs average much less than Japanese costs.

The commonly heard Japanese refrain that U.S. industry has not made the effort to penetrate the Japanese market is not true for the wood products industry. For more than twenty years, this industry has spent hundreds of man-years and millions of dollars seeking to further penetrate the Japanese market. I stress these things to make it clear that we know the market, we're the most efficient producers in the world, and we would increase sales dramatically except for the tariffs and non-tariff barriers.

The Alliance for Wood Products Exports was formed because despite our efforts and competitiveness, sales to Japan lag well below potential levels. For example, over 70% of Japan's imports of U.S. wood products by value in 1988 were raw materials.

The reason the U.S. industry does not reach its potential in Japan is an interrelated web of tariff and non-tariff barriers impeding importation and use of wood products. Elimination or significant reduction of these barriers could increase exports of processed U.S. wood products by from $1 to $2 billion annually.

These barriers can be grouped into seven primary categories:

First is tariffs and tariff escalation. Japan's practice of applying no tariffs on raw materials and escalating tariffs on value-added products results in effective rates of protection on many important wood products of two or three times the nominal rate. For example, as the recent Department of Commerce Study showed, Japan's 10% tariff on softwood plywood provides an effective rate of protection of over 26%. This deliberate system of tariff escalation strongly skews Japan's imports toward the importation of raw materials and away from the importation of value-added products. In effect, the system robs the U.S. industry of its competitive advantage.

This problem must be addressed. Without elimination of these tariffs, the Japanese market will remain largely closed to value-added products.

Unnecessary restrictions in Japan's wood standards and codes also severely restrict importation and use of wood. For example, Japan prohibits the construction of garden apartments and commercial buildings out of wood. The Ministry of Construction classifies Oriented Strand Board with particleboard, despite the fact that OSB is structurally competitive with plywood. Product certification for imported products involves duplicative requirements and adds unnecessary expense and time to importation of U.S. wood products. These are only a few examples of the standards and code barriers which impede both importation and use of wood products.

Third, Japan misclassifies a number of laminated wood products in its tariff schedule, artificially increasing the tariff from 3.9% to 15–20%. This has a big bottom-line effect on companies like PlumCreek which would like to sell more laminated lumber in Japan. Japanese customers want these products, but this illegal misclassification limits our ability to export.

Fourth, Japan provides its wood industry with numerous subsidies. Of particular concern to the U.S. industry are subsidies intended to counter market opening efforts and which result in increased production. For example, after the MOSS talks, Japan authorized over $1 billion in subsidies to counter-act the effects of market liberalization. This must not happen again.

In addition to these groups of barriers, Japan's wood products market is protected by three structural barriers which are also being addressed in the Structural Impediments Initiative.

Inefficient land/housing policies in Japan severely limit the consumption of wood products by favoring agricultural uses of land over residential uses. Reform in this area would not only dramatically increase importation and use of wood products, but would substantially improve Japan's standard of living.

Anticompetitive practices abound in Japan's wood products industry as in other industries. If Japan refused to sanction cartels in logs, lumber and plywood (whether temporary "rationalization" cartels or otherwise), U.S. wood products producers would have more of an opportunity to compete fairly in Japan.

As with many other products, Japan's distribution system seriously increases the cost of wood products. Relief in this area could be very valuable. For starters, the Administration should include wood products among those products which it monitors to determine if Japan's price structure is excessive.

In May, the Administration named barriers to Japan's forest products market as a trade liberalization priority under the Super 301 provisions of the 1988 Trade and Competitiveness Act. Negotiations to eliminate these barriers are underway, and the industry is providing whatever support is possible.

With respect to the structural issues, liberalization of the Japanese market could result in enormous long-term gains for both the Japanese consumer and potential U.S. suppliers. While the industry fully supports the Structural Impediments Initiative, it has also asked the Administration to discuss wood products specific structural issues in the bilateral forest products negotiations.

In spite of the Administration's efforts to date, the industry is seriously concerned about results. The binational process must result in the elimination of a broad range of Japanese barriers, in particular tariffs. Elimination of minor technical barriers will not result in the real export gain which should be obtained.

Similarly, addressing structural barriers for wood products, whether in the Structural Impediments Initiative, cannot serve as a substitute for progress in the bilateral 301 negotiations on wood products.

Reform of Japan's distribution system and anticompetitive activities will not open the Japanese wood products market until the tariff and standards/codes barriers are eliminated. This is my central message to this Committee. The wood products industry will be in the vanguard of support for SII, but real gains must be made in the current sectoral talks on wood products.

The Alliance for Wood Products Exports, on behalf of the U.S. wood products industry, urges Congress to support structural reform in Japan. At the same time, the Alliance strongly urges Congress to insist that real progress be made in opening the sectoral markets which have been identified as trade priorities, in particular elimination of Japanese tariffs which severely limit importation of wood products.

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## PREPARED STATEMENT OF JULIAN C. MORRIS

### INTRODUCTION

As the representative of more than 2,000 American producers and sellers of original equipment (OE) and replacement, or aftermarket, parts the Automotive Parts & Accessories Association (APAA) supports the Structural Impediments Initiative and the special role it now plays in APAA's long quest for greater openness in the Japanese parts buying and distribution systems.

The openness of the U.S. market has enabled strong sales and profits for Japanese auto and parts making industries. It is time Japan is told in volume and tone that cannot be ignored that the price of continued openness is reciprocal access for U.S. suppliers in Japanese parts markets.

Designated by the Administration as an important adjunct of the Super 301 process, SII is the latest of four negotiated attempts this decade to build parts trade. And, given the dramatic nine-fold swelling of the parts trade imbalance over the course of prior efforts, shown in Appendix A, we believe it should be the last. Moreover, APAA believes the SII should be the final word on Japanese structural reform because Congress has equipped U.S. negotiators with the potent Super 301 market opening tool.

APAA members make and sell the entire spectrum of automotive parts, accessories, tools, equipment, chemicals and supplies. APAA's 1,000 U.S.-based manufacturing members represent a very significant share of the universe of 2,000 firms cited by USDOC as being engaged primarily or solely in automotive parts and accessories production for both OE and aftermarket consumption.

Thus, when I speak of APAA as industry's representative, the term refers to this vast number of firms. It does not imply that APAA speaks for every firm in the industry universe nor that APAA is the only group representing the large, diverse U.S. parts industry.

My statement will address Japanese automotive industry parts sourcing and distribution barriers and the transplanting of these closed systems to the U.S.; discuss the appropriateness of Super 301 treatment should the SII talks fail to reform Japanese systems; and review APAA backed policy initiatives and proposals for results-oriented talks to redress the huge trade imbalance.

### IMPACT OF JAPANESE STRUCTURAL IMPEDIMENTS

Foreign car makers who can secure a significant share of the rich, open U.S. market while protecting their home market from import competition, always enjoy the upper hand in economies of scale and gain a global competitive advantage. For over 10 years and three Administrations America's auto parts industry has warned that this is the case with the Japanese.

The structure of Japan's automotive industry long has excluded U.S. firms from equipping Japanese nameplate cars that dominate the world market. The International Trade Commission1s December 1987 report, *Global Competitiveness: The U.S. Automotive Parts Industry*, (USITC Publication 2037) excerpted in Appendix B, provides an extensive discussion of the various Japanese industrial groupings, or keiritsus, each of which includes an auto producer, bank, related parts makers, and other financial and industrial operations.

The fact that keiritsus interweave companies "through equity exchanges, interlocking directorates, intra-group financial commitments, joint R&D efforts, and membership to exclusive management councils or clubs" has the reported, well-known effect of making it "difficult for potential outside suppliers (domestic or foreign) to sell to companies in the group." Japanese structural barriers figured prominently in U.S. parts makers' responses to the USITC's 1987 global competitiveness report as shown in the attached table (Appendix C).

The foremost structural impediment APAA knows of in U.S.-Japan parts trade, keiritsus tie Japanese OEM's and suppliers so tightly that a leading Japanese newspaper, the Nihon Keizai Shimbun, portrays Japanese suppliers as "vertically integrated Japanese parts companies." They further are likened to "faithful servants of a feudal warrior chief."

### PARTS PROCUREMENT BARRIERS IMPORTED

APAA consistently has warned of the threat of market erosion for American made original equipment and aftermarket sales. Japanese auto/parts inroads in the U.S. through (1) direct and captive imports bearing little U.S.-made content, (2) transplant assembly using largely Japanese content and (3) greater Japanese-controlled parts in Big Three production could give Japanese auto/parts makers the potential to control between 40% and 50% of the content of all cars sold in America in the 1990's.

Already vulnerable, our industry now faces its gravest threat and the prospect of permanent preclusion from the transplant assembly market as hundreds of Japanese suppliers move on shore. Moving here originally to keep tight ties with Japanese car makers, these companies have set their sights on selling to Big Three customers, and to cracking the lucrative U.S. aftermarket.

Indeed, in testimony cited by the USITC, former Commerce Assistant Secretary H.P. Goldfield explained that traditional Japanese family-like manufacturer-supplier relationships not only pose the primary barrier to U.S. auto parts sales to Japanese OEM's, but by their importation to the U.S. also "have effectively precluded many U.S. suppliers from participating in this huge, fast-growing" transplant assembler market.

While the falling dollar should have sharpened the competitive edge of American companies seeking transplant sales, in many cases it turned against us by casting the U.S. as an investment bargain for the Japanese. Japanese car companies pass over attractively priced quality U.S. parts for parts from related Japanese supplier

Plants set up here. And these parts plants, like their car company customers, continue to import capital goods and subcomponents for their assembly operations and thereby contribute to the U.S. trade deficit. *Indeed, Japanese automotive investment in the U.S. appears to be increasing, rather than trimming, the trade deficit.*

### CLOSED PARTS DISTRIBUTION WEB IMPORTED

Japan's closed parts distribution web has joined the closed parts buying system in the U.S. It is getting harder for America's independent aftermarket retailers and service outlets to provide replacement parts to owners of Japanese nameplate cars. Tightly controlled OE producers generally restrict replacement parts sales to the car dealer network only. And, since most U.S. and other independent parts makers do not have the economies of scale that OE sales provide, tool up costs for purely replacement parts production can be prohibitive.

### PARTS INDUSTRY'S PRIORITIES FIT SUPER 301 CRITERIA

In comments submitted as part of the Super 301 prioritization process and in follow-up meetings with the Office of USTR, APAA reiterated our chief objective: to break the chains binding Japanese car companies and Japanese suppliers to the exclusion of U.S. companies. Auto parts trade's potential candidacy for Super 301 treatment stands on three important planks:

(1) *The potential for significant sales increases should we succeed in loosening Japanese OEM/supplier bonds is enormous.* More U.S. parts sales to Japan-based OEM's would spur exports while more U.S. firms' sales to Japanese transplant assemblers would cut Japanese parts imports. Working together they could shave the automotive products half of our bilateral trade deficit. The following statistics are evidence of the staggering challenge we face in cutting the parts trade deficit with Japan:

—Japan's parts trade surplus increased five-fold between 1982 and 1988, from $1.6 billion to $9 billion.

—Japanese OEMs' almost total reliance on Japanese suppliers holds U.S. sales to $300 million, less than one third of one percent of Japan's $85 billion market.

—Japan's transplant assemblers in the U.S. have domestic sourcing ratios of *less than 40 percent,* a growing share of which is made by Japanese migrant suppliers.

—The true parts trade deficit includes that quarter of Japan'S $85 billion parts market devoted to building $24 billion in cars and light truck exports to the U.S.

(2) The *significant precedent* that could be set, by breaking through the shell surrounding Japanese OEM/supplier families to the exclusion of U.S. suppliers, would warn emerging auto producing nations to steer clear of structural barriers.

(3) *As to the likelihood of success,* APAA believes that Japan and other nations cited depend on continued U.S. market access, giving America the most potent market opening tool. As former Undersecretary Smart said at the August 1986 opening MOSS round, Japanese auto makers who benefit the most from access to the vast U.S. market also stand to lose the most unless Congress sees tangible market opening results.

APAA believes that the Super 301 leverage is so important to the current SII talks, that we have attached as Appendix D our suggested refinements for the 1990 Super 301 exercise as well as for the preparation of subsequent National Trade Estimate reports.

### U.S. POLICY BUILDING

Although the 1980's have been punctuated by three key U.S. government initiatives to crack keiritsu created barriers, U.S.-Japan auto parts trade figures (Appendix A) signal failure of increasing proportion.

Indeed, the U.S. ends the decade with this USTR diagnosis of the problem pronounced in the 1989 National Trade Estimate (NTE):

> A prerequisite for selling most functional auto parts to Japanese vehicle makers is to become part of their supplier "family." "Nonfamily" suppliers are precluded from both the original equipment and replacement (aftermarket) auto parts markets for Japanese vehicles. *The United States is trying to persuade Japanese vehicle manufacturers to increase their purchases of competitive, high quality U.S. auto parts.* (Emphasis added.)

While APAA vigorously supports continued, intensified bilateral negotiations aimed at increased sales, we believe the 1989 language should have incorporated the following strong statement which the USTR made in the 1987 NTE: The "United

States is trying to persuade Japanese manufacturers to *give fair consideration to competitive, high-quality U.S.-made parts.* (Emphasis added.)

APAA sees the statements as complementary, in that it should not be difficult to get Japanese OEM's to increase their purchases of U.S. parts once our industry firms get fair consideration.

With Japanese cars taking increasing shares here and globally, American trade leaders should take very serious note of the USTR's 1989 NTE finding that Japan's automotive industry structure "precludes," or rules out in advance the use of U.S. OE and aftermarket suppliers.

Gaining a fairer shake at supplying the Japanese car building and aftermarket service parts markets in the U.S. Japan, and third markets was supposed to be the overriding goal of the U.S.-Japan Market Oriented, Sector Selective (MOSS) talks that concluded in August 1987.

Today, over two years after the concluding MOSS round, little U.S. sales progress is evidenced in significantly cracking Japanese parts markets for high value-added components and systems. MOSS failed in its primary goals of reforming Japanese sourcing practices in large part because of the control the U.S. allowed Japan to exert over the agenda itself.

Sidestepping America's primary MOSS objectives, Japan cherrypicked lesser items such as trade promotion and sales monitoring from our negotiators' list of objectives. Five of seven negotiating sessions were mired down by the issue of how Japan would self-monitor post-MOSS progress. Rather than crafting a system that measures the genuine successes of traditionally excluded U.S. firms, the agreement our government endorsed allowed Japan credit for purchasing from their transplanted traditional suppliers now locating in the U.S. This means our government effectively is rewarding Japanese OEM's for keeping the same tight bonds that the negotiations were intended to loosen.

The fact that the Administration's prescribed regimen as stated in the 1989 NTE offers two post-MOSS tonics which hardly fit the malady diagnosed—Japanese self-monitoring of U.S. parts purchases and greater Japanese Government assistance with trade promotion events—indicates continued Japanese control of the parts trade agenda. As subsidiary goals they can support but never substitute for the primary goals of reforming Japanese parts sourcing practices.

## RECOMMENDATIONS

APAA believes the SII talks have set the agenda firmly towards keiritsu reform. This new initiative also has tremendous potential to both reinvigorate the remaining years of the post-MOSS bilateral talks, and to redirect those negotiations to tackle the goals of automotive industry structural changes, goals that heretofore have eluded the MOSS process.

In addition to the SII and post-MOSS talks, the 1988 trade act's Quayle Amendment mandates a five-year, MOSS like Japanese parts market opening initiative. These three initiatives should buttress one another, adding strength to our appeal to the Japanese Government for dismantling what the trade act calls unacceptable Japanese barriers to U.S. OE and aftermarket sales.

APAA has high expectations for SII and related reform efforts, because they stand on the Super 301 foundation, which the 1988 trade act architects built as a no-nonsense, results-oriented approach towards correcting trade abuses. To help drive these negotiating vehicles APAA urges:

(1) Promptly convene the new auto parts industry advisory committee charged with helping shape the Quayle initiative.

(2) Since private, not government, barriers are at issue, it is vital to define successful outcomes. The 1980 bilateral parts trade approach should be revived, including an update of Japan's 1980 parts purchase target and the establishment of timetables.

(3) Send Japan a strong signal by having Commerce follow the semiconductor industry precedent for monitoring progress, and collect voluntarily submitted data on U.S. capital-affiliated firms' sales to Japanese parts markets. Similar Commerce monitoring of U.S. firms' sales was key to the 1980 effort.

(4) Continue joint trade development efforts with stringent, bilateral follow-up monitoring of related sales progress.

(5) Remind Japan that the potent new Riegle/Levin amendment of Section 301 now holds foreign governments accountable for the lack of fair commercial consideration of U.S. products.

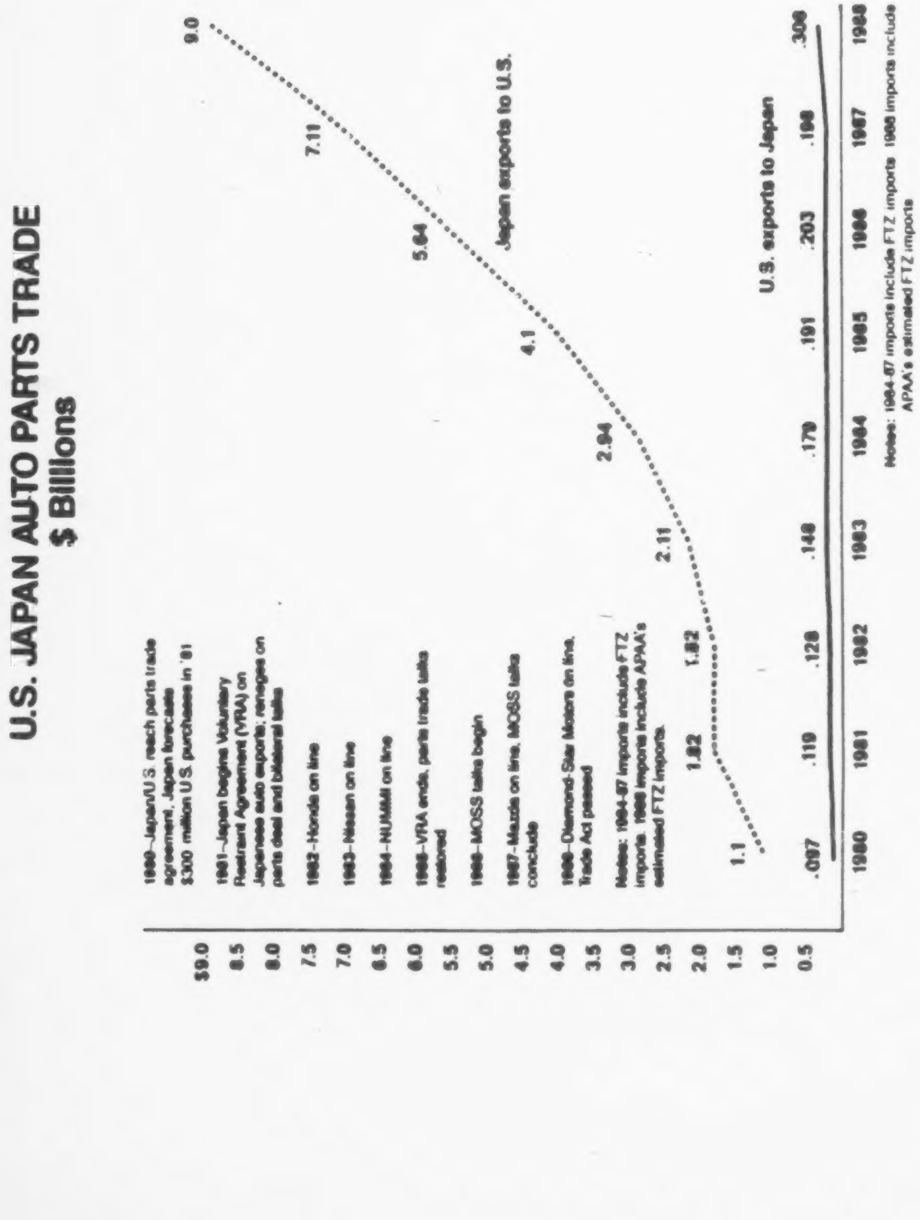
(6) Here at home, reform of the Foreign Trade Zone automotive subzone program is needed to end multi-million U.S. tariff concessions that now help each transplant OEM sustain the tight family links that exclude our sales. The first negotiating pri-

ority should be attainment of reciprocal market access. Only then should we move on to negotiate reciprocal perks.

APAA is eager to work with this subcommittee, the Congress and the Administration towards a successful SII that moves us well beyond reform blueprints and downpayments to accelerated payments and a trade structure that assures fair commercial consideration.

Attachments.

APPENDIX A



APPENDIX B

# U.S. GLOBAL COMPETITIVENESS: THE U.S. AUTOMOTIVE PARTS INDUSTRY

Report to the Committee on Finance,
U.S. Senate, Investigation
No. 332-232 Under Section
332 (g) of the Tariff Act of 1930

USITC PUBLICATION 2037

DECEMBER 1987

United States International Trade Commission / Washington, DC 20436

Import duties on selected automotive parts entering France range from about 5 to 14 percent ad valorem; the value-added tax ranges from almost 19 percent to 33 percent, as shown in the following tabulation: 1/

| | Import duty | Value-added tax |
|---|---|---|
| Bearings: iron, self-lubricating, and porous... | 4.9 | 18.6 |
| Shock absorbers............. | 8.2 | 18.6 |
| New car tires............... | 5.8 | 18.6 |
| Car radios with speakers.... | 14.0 | 33.3 |

Government programs.--Although the industry does not receive direct Government assistance, the Government is nevertheless present through the nationalized automaker, Renault. Industry sources indicate that there is some discussion of changing Renault's legal status from "state agency" to "nationalized company." The change may be one step towards the company's privatization.

### Japan

Industry structure.--There are over 10,000 producers of automotive parts in Japan employing some 600,000 persons. Approximately 8,000 of these producers are small firms having 29 workers or less, about 1,300 are medium-sized firms having 30 to 99 workers, and about 600 are large companies having 100 or more workers. 2/

Most Japanese auto parts producers are affiliated with one of the 11 Japanese automakers. Most of the auto producers are linked to larger networks of Japanese companies representing a wide range of industries. These networks are known as "keiritsu" industrial groups. The keiritsu structure links firms in different industries to form conglomerations of companies. The keiritsu structure is an interweaving of companies through equity exchanges, interlocking directorates, intra-group financial commitments, joint R&D efforts, and membership to exclusive management councils or clubs. The objective of these groups is to work collectively to increase total group sales and employment. Member companies generally have a strong tendency to purchase from other member companies; this structure makes it difficult for potential outside suppliers (domestic or foreign) to sell to companies in the group. 3/

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1/ According to an April 1987 report from the U.S. Embassy.
2/ The Structure of the Japanese Auto Parts Industry, Dodwell Marketing Consultants, 1986, and Stephan B. Wickman, "The Character and Structure of the Economy," Japan: A Country Study, ed. Fredericka Bunge (Washington, DC: The American University, 1983), pp. 141-196.
3/ The Structure of the Japanese Auto Parts Industry, Dodwell Marketing Consultants, 1983.

There are six major keiritsu groups in Japan. At the core of each is a major Japanese bank. 1/ Tied to the bank and to each other are such diverse operations as raw material producers, manufacturers of intermediate and final products, and service providers such as trading companies, insurance firms, shipping lines, construction companies, and other ancillary service providers. In 1984, these six groups accounted for almost 18 percent of net profits of all Japanese businesses, almost 17 percent of total sales, over 14 percent of paid-up capital, and almost 5 percent of the Japanese work-force (fig. 4-4). 2/ The groups and their affiliated auto producers are Mitsui (Toyota Motor Co.) 3/, Mitsubishi (Mitsubishi Motors), Sumitomo (Toyo Kogyo, commonly known as Mazda), Fuyo (Nissan), 4/ Sanwa (Daihatsu), 5/ and Dai-chi Kangyo (Isuzu Motors). Other Japanese auto producers are associated with smaller, less organized industrial groups such as Suzuki Motors, part of the Tokai group. The largest Japanese auto producer that has no apparent group affiliation is Honda Motor Co.

The Japanese auto producers, together with their affiliated auto parts producers, are typically large enough to be considered "keiritsu" style groupings. 6/ The major auto producing groups are the Toyota group (includes Daihatsu Motors and Hino Motors through equity interest), the Nissan Group (includes Fuji Heavy Industries Group and the Nissan Diesel Group through equity interest), the Toyo Kogo Group, Honda Motors, Mitsubishi Motors, Isuzu Motors, and Suzuki Motors.

Japanese auto producers rely more heavily on noncaptive suppliers than U.S. auto producers. The U.S. average for outsourcing of parts by automakers is 50 to 55 percent; for Japanese automakers, the average is about 75 percent. The auto producers typically set up associations of their parts suppliers known as "Kyoryokukai" to enhance cooperation and solidarity. Although the recent trend has been towards a slight relaxation of group ties, members of these associations typically sell most of their output to their one, affiliated auto producer. Parts producers are usually very specialized, and produce only one or two types of parts. On the other hand, each particular automobile part used by an automaker is typically produced by several companies within each Kyoryokukai, so that the auto producer has multiple suppliers, thus encouranging competition in price and quality. 7/

The Toyota Motor Co., Japan's largest auto producer (with 3.7 million vehicles produced in 1985), has 220 primary auto parts suppliers and over 1,000 secondary and tertiary suppliers. Toyota has formed two auto parts

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1/ Henry C. Wallick and Mable Wallick, "Banking and Finance," Asia's New Giant, How the Japanese Economy Works, ed. Hugh Patrick and Henry Rosovsky (Washington, DC: The Brookings Institute, 1976) p. 294.

2/ Masaichi Hiogami, "Industrial Groups," Japan Economic Yearbook, 1986.

3/ Toyota is a significant grouping unto itself and only loosely connected to the Mitsui Group.

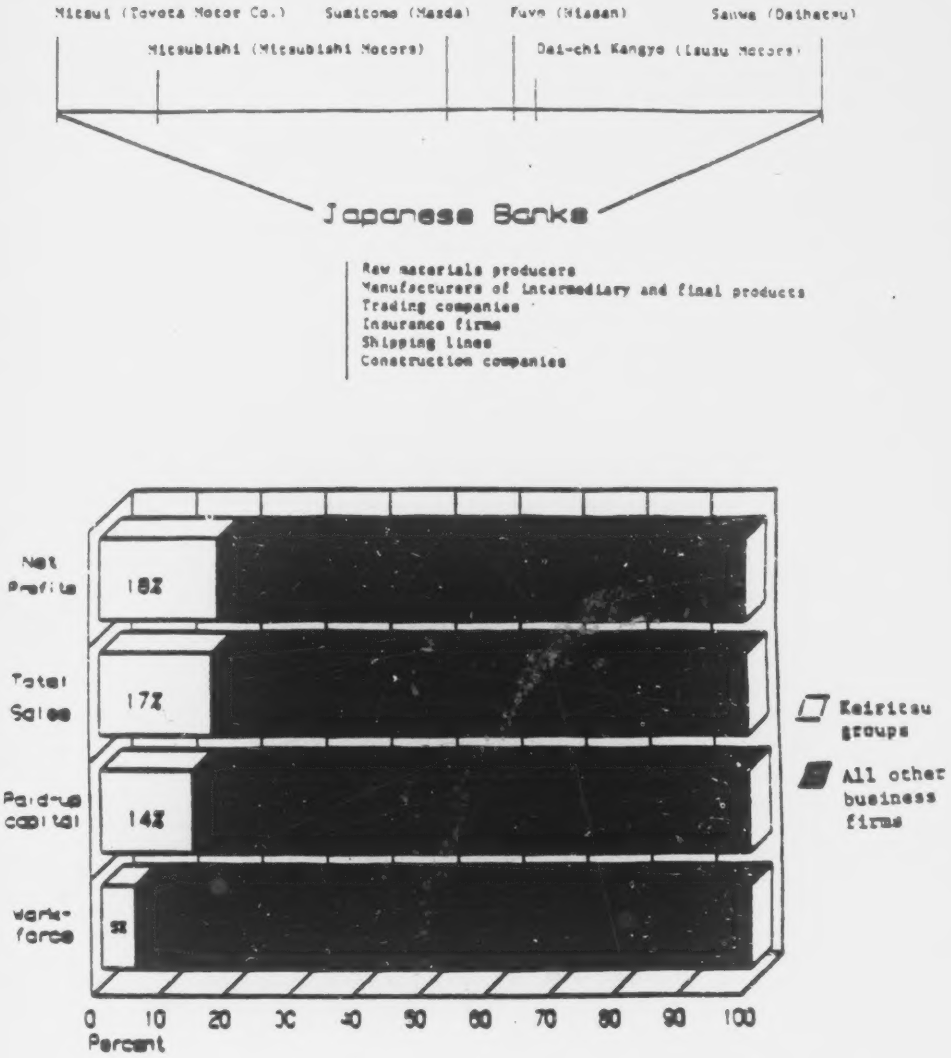
4/ Nissan is also a significant group unto itself and only loosely connected to the Fuyo Group.

5/ Toyota has equity interest in Daihatsu.

6/ Industrial Groupings in Japan, Dodwell Marketing Consultants, 1985.

7/ "The Relationship Between Japanese Auto and Auto Parts Makers," prepared by Mitsubishi Research for the Japan Automobile Manufacturers Association, 1987, and USITC staff interview with the Ministry of International Trade and Industry officials, Tokyo, Japan, Apr. 20, 1987.

Figure 4-4
Keiritsu groups: Structure of the six Keiritsu groups and their role in the Japanese economy, 1984.



Source: Masaichi Hiogami, "Industrial Groups," Japan Economic Yearbook, 1986.

supplier groups: Kyoho-Kai and Eiho-Kai. Toyota's equity interest in its affiliated suppliers ranges from 1.4 percent to 60.4 percent, with the average around 25 to 30 percent. Toyota has a 14.6 percent interest in Daihatsu, Japan's ninth largest automaker (with 1985 production of 579,000 vehicles), and a 10.4 percent interest in Hino Motors, a leading Japanese truck manufacturer (with 1985 production of 69,063 vehicles). Daihatsu Motors has approximately 140 primary suppliers, and its parts association is called Daihatsu Kkoyu-Kai. Hino Motors has some 220 primary suppliers that form the parts association Hino Kyoryoku-Kai. 1/

The Nissan group is comprised of Nissan Motor Co., Nissan Diesel, and Fuji Heavy industries. Nissan Motor Co., the second largest Japanese auto producer (with production of 2.5 million vehicles in 1985), has about 160 primary auto parts suppliers and some 800 secondary and tertiary suppliers. Nissan's two supplier associations are Takara-Kai and Shoho-Kai. Nissan Diesel has 60 parts suppliers that form the association Nissan Diesel Yayoi-Kai. Nissan Diesel produced 36,351 trucks and buses in 1985. Fuji Heavy Industries, which ranked eighth in vehicle production in 1985 with 584,384 vehicles, has a total of more than 700 suppliers that are divided into three Kyoryokukai's: Gunma Kyoryoku-Kai, Kyoryoku-Kai, and Isesaki Kyoryoku-Kai. 2/

The Toyo Kogyo group, which ranked third in production of automobiles in 1985 (with almost 1.2 million vehicles), has some 250 primary suppliers that form two supplier associations, Yoko-Kai and Toyu-Kau. Mitsubishi Motors, the fourth ranking Japanese auto producer in 1985 (with almost 1.2 million vehicles), has 340 primary parts suppliers that form the Kashiwa-Kai association. Honda, ranked fifth in 1985 (with production of slightly more than 1.1 million vehicles), has some 400 to 500 suppliers, but does not have them grouped into supplier associations like the other major auto producers. Suzuki Motors has some 101 primary suppliers grouped into the Suzuki Kyoryoku Kyodo Kumiai auto parts association. In production, Suzuki was ranked as the sixth largest Japanese auto producer in 1985 (with production of 781,901 vehicles). Isuzu, the seventh largest Japanese producer of automobiles in 1985 (with 587,015 vehicles), has 279 primary suppliers grouped into the Isuzu Kyowa-Kai parts association. 3/

Even though there seems to be some movement in Japan to relax the relationship between parts producers and automakers, each parts supplier is still heavily dependent on purchases from the patron automaker. This whole concept of industrial grouping along the lines of the keiritsu structure has caused problems for foreign producers trying to penetrate the Japanese market. 4/

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1/ World Motor Vehicle Data, 1987, Motor Vehicle Manufacturers Association; and The Structure of the Japanese Auto Parts Industry, Dodwell Marketing Consultants, 1983.

2/ World Motor Vehicle Data, 1987, Motor Vehicle Manufacturers Association; and The Structure of the Japanese Auto Parts Industry, Dodwell Marketing Consultants, 1983.

3/ Ibid.

4/ Indicated from responses to Commission questionnaires. See also Rodney Clark, The Japanese Company (New Haven, CT: Yale University Press, 1979) pp. 73-87.

The Japanese Auto Parts Industries Association (JAPIA) has about 300 members who account for approximately 80 percent of industry production. 1/ Most member companies have direct transactions with major automakers. JAPIA members' production increased by 50 percent during 1982-85 to $49.1 billion in 1985 (table 4-6). Production of original equipment parts increased at a faster rate than did production of aftermarket products; production for export rose by 131 percent to $3 billion in 1986 (fig. 4-5). The total number of employees increased from 280,000 in 1982 to 329,000 in 1986; the number of production workers rose by 14 percent during 1982-86 to 199,000 in 1986. In addition, shipments and R&D expenditures increased during 1982-86, as did R&D as a percentage of sales (table 4-7).

Table 4-6
Automotive parts: JAPIA members' production and employment, 1982-86

| Item | 1982 | 1983 | 1984 | 1985 | 1986 | Annual average, percentage change, 1986 over 1982 |
|---|---|---|---|---|---|---|
| Total production (billion dollars) | 32.7 | 38.8 | 43.3 | 49.1 | 1/ | 10.7 |
| Employment: | | | | | | |
| Production workers (number) | 173,912 | 174,377 | 182,192 | 192,105 | 198,702 | 3.4 |
| Office workers (number) | 105,737 | 113,412 | 112,930 | 125,943 | 130,269 | 5.4 |

1/ Not available.

Source: Report from the U.S. Embassy, Tokyo, Japan, March 1987.

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1/ USITC staff interview with JAPIA officials, Tokyo, Japan, Apr. 20, 1987.

Source: U.S. GLOBAL COMPETITIVENESS:
THE U.S. AUTO PARTS INDUSTRY, USITC 2037
December 1987

**Table 6-1**
**Automotive parts: Nontariff barriers experienced by U.S. producers in foreign markets, by countries, 1982-86**

| Category | Country(ies) | Percentage of total respondents |
|---|---|---|
| Quantitative restrictions and similar specific limitations: | | |
| Licensing requirements | Colombia | 23 |
| | Mexico | 20 |
| | Venezuela | 19 |
| | Brazil | 19 |
| Quotas | Venezuela | 6 |
| | Mexico | 5 |
| Embargos | Mexico | 5 |
| Export restraints | Brazil | 7 |
| Exchange and other monetary or financial controls | Venezuela | 27 |
| | Brazil | 17 |
| | Mexico | 15 |
| | Canada | 15 |
| Maximum/minimum price regulations | Venezuela | 3 |
| | Mexico | 2 |
| | Argentina | 2 |
| Local content requirements | Mexico | 33 |
| | Brazil | 18 |
| | Venezuela | 13 |
| | Korea | 10 |
| Restrictive business practices | Japan | 20 |
| | Korea | 9 |
| | Mexico | 6 |
| Discriminatory bilateral agreements | West Germany | 3 |
| | France | 3 |
| Discriminatory sourcing | Japan | 16 |
| | Korea | 3 |
| | Brazil | 3 |
| Nontariff charges on imports: | | |
| Border taxes | Mexico | 15 |
| | Canada | 8 |
| Port and statistical taxes | Canada | 2 |
| | Venezuela | 2 |
| | Brazil | 2 |
| Nondiscriminatory use and excise taxes and registration fees | West Germany | 2 |
| Discriminatory excise taxes, government controlled insurance, use taxes, and commodity taxes | Brazil | 3 |
| | Israel | 2 |

Table 6-1
Automotive parts: Nontariff barriers experienced by U.S. producers in foreign markets, by countries, 1982-86--Continued

| Category | Country(ies) | Percentage of total respondents |
|---|---|---|
| Nontariff charges on imports--Con. | | |
| Nondiscriminatory sales tax........... | Canada | 2 |
| Discriminatory sales tax.............. | Mexico | 2 |
| Other taxes and fees.................. | Australia | 2 |
| | Canada | 2 |
| Government participation in trade: | | |
| Subsidies and other aids.............. | Japan | 14 |
| | Brazil | 8 |
| | Mexico | 8 |
| | Venezuela | 7 |
| State trading, government monopolies, and exclusive franchises................ | Venezuela | 5 |
| | Hungary | 5 |
| | Mexico | 3 |
| | Romania | 3 |
| Trademark, patent, and other intellectual property laws which discourage imports............ | Mexico | 3 |
| Government procurement................ | Iraq | 5 |
| | Iran | 3 |
| Standards: | | |
| Health and safety standards........... | Australia | 2 |
| Product content requirements.......... | Mexico | 5 |
| | Brazil | 3 |
| | Korea | 3 |
| Processing standards.................. | Venezuela | 1 |
| | Japan | 1 |
| Industrial standards............. | Japan | 2 |
| Requirements on weights and measures.. | Japan | 2 |
| Labeling and container requirements.............. | Canada | 3 |
| | Mexico | 2 |
| Marketing requirements................ | Canada | 2 |
| Packaging requirements................ | Canada | 1 |
| | Japan | 1 |
| Trademark problems.................... | Taiwan | 3 |
| | Brazil | 2 |
| Customs procedures and administrative practices: | | |
| Antidumping practices................. | Spain | 2 |
| | West Germany | 2 |
| Customs valuation..................... | India | 3 |
| | Brazil | 3 |

Table 6-1
Automotive parts: Nontariff barriers experienced by U.S. producers in foreign markets, by countries, 1982-86--Continued

| Category | Country(ies) | Percentage of total respondents |
|---|---|---|
| Consular formalities | United Arab Emirates | 6 |
| | Kuwait | 5 |
| | Saudi Arabia | 5 |
| Documentation requirements | Japan | 3 |
| | Canada | 2 |
| | Brazil | 2 |
| | Mexico | 2 |
| Administrative difficulties | Japan | 2 |
| | Venezuela | 2 |
| Merchandise classification problems | Japan | 2 |
| Regulations on samples, returned goods, and re-exports | Venezuela | 3 |
| | Colombia | 3 |
| Countervailing duties | Brazil | 1 |
| | Japan | 1 |
| | Israel | 1 |

Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

More than any other country, Japan has been accused of erecting barriers to U.S. auto parts exports. Specific actions consistently noted by U.S. companies include alleged unfair links between Japanese suppliers and Japanese automakers, unreasonable delays in negotiations for contracts, difficulty in obtaining the information necessary for bids, unreasonable engineering or design standards, and frequent product modification requests.

According to Commerce's Assistant Secretary for Trade Development, the primary barrier to U.S. auto parts sales to Japanese vehicle manufacturers are not Government barriers, but rather the traditional family-like manufacturer-supplier relationships that exist in Japan (see description of the Japanese keiritsu system, pps. 4-12 to 4-14). He claimed that these relationships apply not only in the Japanese market (estimated to be a $50 billion market), but also at the new Japanese vehicle assembly plants in the United States. He adds that these ties "have effectively precluded many U.S. suppliers from participating in this huge, fast-growing market." 1/ The difficulties encountered in trying to penetrate the Japanese market have recently prompted political negotiations (see MOSS talks, p. 6-16) to improve the situation. However, several U.S. manufacturers argue that the Japanese vehicle producers are not serious about buying U.S.-made parts, but are showing interest only because of pressure exerted by both the Japanese and U.S. Governments. 2/

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1/ Transcript of the hearing, pp. 6-8.
2/ "Counterfeit Parts: A $3 Billion a Year Industry," Automotive Parts International, Dec. 30, 1986, p. 6.

APPENDIX D

AUTOMOTIVE
PARTS &
ACCESSORIES
ASSOCIATION

## RECOMMENDED REFINEMENTS TO THE SUPER 301/NTE REPORT PROCESS

To ensure that America moves steadfastly towards our free trade objectives, APAA suggests the following steps to enhance the process for the 1990 Super 301 exercise as well as for the preparation of subsequent National Trade Estimate (NTE) reports:

(1) The Super 301 public comment period should commence much earlier next year, and a Federal Register notice and comment period for NTE preparation in subsequent years is strongly recommended. The comment period should last at least two months. The responsible industry sector staff within USTR, and others in the interagency process should seek and incorporate more public comment, supplementing the important, albeit limited, ISAC level participation.

(2) Strong USTR coordination of the interagency process should begin with the publication of key contacts named by each agency at both the staff and policy making levels.

We stress the need for contacts because the process is best served by industry and government knowing one another and exchanging information. It also builds an important element of public accountability into the process.

(3) Industry sector contacts should make preliminary report copy available to all extent possible to interested parties. Material available only to ISAC members should be more easily accessible to members wishing to contribute to the report drafting process. Of course, the aspect of accountability hinges on agencies providing some indication as to the disposition of industry recommendations.

(4) Federal Register notice of interagency hearings should provide all interested parties the opportunity to testify or participate in a second round of written comments. Through past experience APAA finds the give and take of interagency hearings to be invaluable in gaining the viewpoint of various policy makers. This public airing of issues, unlike the closed ISAC process, stimulates discussion and enhances policy making.

(5) Finally, we believe that when the final selections are made, interagency contacts should provide interested parties with some rationale for excluding major items.

(6) The Congressional hearing review process provides a final and very important safeguard to ensure Administration responsiveness to American industries and workers.

5100 FORBES BLVD., LANHAM, MD 20706, 301/459-9110, TELEX: 4990739-APAA INT (VIA ITT)

## PREPARED STATEMENT OF R.K. MORRIS

Mr. Chairman, Members of the Subcommittee, my name is R. K. Morris, and I am Director of International Trade Policy for the National Association of Manufacturers. I am pleased to be here today to discuss the structural impediments initiative (SII) between the United States and Japan.

I want to state clearly and at the very beginning of my testimony that the National Association of Manufacturers supports the action taken by the Administration this past May in initiating the SII negotiations. Since these negotiations grew out of the Super 301 provisions of the 1988 Omnibus Trade and Competitiveness Act, I would like to begin by focusing on how the NAM approached the Super 301 issue.

### SUPER 301 PROVISIONS

In candor I should point out that NAM's strong support for the Omnibus Trade and Competitiveness Act of 1988 was independent of the special new negotiation requirements it contained, requirements which we all know as Super 301. This is not to say that Super 301 is in any way inconsistent with the Act as a whole; quite the contrary. The Omnibus Trade and Competitiveness Act all but begins with the statement that it should be "the highest priority of the United States government to ensure future stability in the external trade of the United States." Super 301 (Section 1302 of the Act) instructs the U.S. Trade Representative to identify certain trade liberalization priorities for the United States. These two objectives could hardly be more compatible or mutually reinforcing.

More than anything else, Mr. Chairman, Super 301 is about U.S. trade priorities. The word appears repeatedly in the text of the statute as if to express Congress's strong determination to see the Executive Branch come to grips with the need to set priorities. The Super 301 decisions of May 25 clearly establish several priorities. The most important of these are:

(i) that a successful Uruguay Round is the single most important market-opening initiative for the Administration at this time;

(ii) that in bilateral terms, America's trade problems with Japan are among the most serious we face. Addressing them effectively must be regarded as a high priority;

(iii) that certain specific Japanese trade practices should be addressed under the Super 301 provisions of the Trade Act, but the larger causes of economic tension between the United States and Japan must also be addressed, and that can be done better in another framework;

(iv) that new techniques and mechanisms should be established for dealing with these larger factors, referred to as structural impediments in the Administration's decisions;

(v) that there are certain basic ideas about the conduct of international trade that the United States believes in and will champion, both in the context of the Uruguay Round and in other settings. One of these is the idea that intellectual property should be protected and protected effectively throughout the community of trading nations.

(vi) Another is the idea that the ability of governments to regulate investment should not become an instrument for furthering beggar-thy-neighbor policies.

There is a broader point to be made as well. Prior to the Administration's announcement on May 25, some on Capitol Hill who were involved in drafting the Trade Act talked to us about the Administration's choices on Super 301 in terms of either a check-list or a strategy. It was pointed out that the Administration could view Super 301 as a series of boxes to be checked off, or it could see in it the opportunity to articulate a trade strategy. I think that was a fair characterization of the options Super 301 offered. NAM believes that the Administration chose the right course; they fashioned a strategy.

### FOCUS ON JAPAN

On May 11, NAM offered its advice as to how we thought the Super 301 provisions of the 1988 Trade Act should be implemented. We did this in the form of a statement submitted to Ambassador Hills and shared with others in the Administration. That statement concentrated solely on Japan. This was not because we thought only one country should be named. I believe most of the company representatives who took part in our deliberations assumed that more than one country would be named a priority foreign country.

Our priority, however, was Japan. More than any other country, Japan has become a symbol of our frustration over the erosion of U.S. international competitiveness. Since 1986, the U.S. trade deficit with Japan has been in the neighborhood of $50-$55 billion (see chart at end of statement).

Those are higher deficits than we have ever run with any other country. And the situation doesn't seem to be improving this year. Our deficit with Japan two-thirds of the way through 1989 stands at $32.5 billion which is almost exactly where it stood at this time last year.

These numbers reinforce what virtually everyone knows: Japan's manufacturers have challenged American industry more profoundly than have those of any other country. Further, Japan is the world's second largest economy, with a GNP of roughly $3 trillion. It is already an enormous U.S. export market—$38 billion in 1988—and it has the potential of being a much larger one.

For these reasons alone, the NAM felt it was essential that Japan be named a priority foreign country under Super 301. Not to have named Japan would have rendered the concept of priorities all but meaningless. We were concerned, however, that the unique opportunity presented by Super 301 would be greatly diminished if all that resulted were new sectoral negotiations associated with the naming of priority practices in Japan. The 1988 Trade Act itself seems to express the same fear when it says (Section 1306 (a)(7)), "our trade and economic relations with Japan are complex and cannot be effectively resolved through narrow sector-by-sector negotiations."

Accordingly, NAM recommended that no priority practices be named. instead, it was our suggestion that the President follow the advice of Section 1306 of the 1988 Trade Act and propose to the Prime Minister of Japan a special economic summit "for the purpose of addressing trade and economic issues." In making this recommendation, we provided USTR with a list of NAM's concerns and expressed the hope that these would figure prominently in future negotiations with Japan. (We also suggested that one or more of them could serve as the basis for a self-initiated 301 case in the event that USTR concluded such action was warranted.)

The Administration's decision on May 25 was right on course. Yes, it named practices, but it also ensured that the dialogue with Japan will be focused on the larger structural issues.

## STRUCTURAL IMPEDIMENTS INITIATIVE

When NAM submitted its May 11 comments to the USTR, we also submitted a list of obstacles affecting our trade with Japan. A copy of this list is attached to my testimony today. Over the past month, we have been conducting a survey to better identify the most important impediments facing U.S. manufacturers trying to export to or do business in Japan. This survey is not yet complete, but I would like to share the preliminary results with the subcommittee today.

Of the approximately 50 companies who have responded so far, at least 90% directly deal with Japan, either exporting to, importing from, operating a joint venture, maintaining subsidiaries, or engaging in some other kind of arrangement. This survey asked for input on several issues with regard to U.S.-Japan commercial relations including: (1) assessing how open the Japanese and U.S. economies are to imports and foreign investment, (2) assessing the importance of the six issues identified by the United States Government in the Structural Impediments Initiative talks, (3) assessing the importance of those issues identified by the National Association of Manufacturers which are not clearly addressed in the SII negotiations, and (4) assessing the importance of the seven areas in the U.S. economy identified by Japan as representing major obstacles to improving the U.S. trade with Japan.

In terms of openness, the companies responding to our survey believe that the Japanese economy is not nearly as open to imports or foreign investment as the U.S. economy is to foreign imports and foreign investment. On a scale of 1 to 5, with 1 representing a very closed economy and 5 a very open economy, the average score for Japan was 1.9 for imports and 2.4 for foreign investment, compared with 4.6 and 4.8 respectively for the United States. In short, it is clear that our membership views Japan's economy as much more closed than the United States'.

In terms of the level of importance for the six issues identified by the U.S. Government, the three issues identified as the most important were: (1) the exclusionary business practices where Japanese firms procure parts and components from long-term business partners to the exclusion of foreign suppliers, (2) the Keiretsu relationship where Japan's "corporate families" or groupings results in vertical control of retailers by Japanese manufacturers and concomitant barriers to foreign companies, and (3) the distribution system which is perhaps better thought of in terms of a series of distribution systems instead of one. In some instances, the distribution systems tend to discriminate against foreign goods. In almost all cases, Japan's distribution systems inflate the prices of final goods to the detriment of American producers and Japanese consumers.

In that sense, all three of these impediments are related because they all ultimately affect how goods get from producers to the consumers. It is clear the Administration focused on issues of major concern to the American business community, but we would add that the U.S. approach to dealing with these issues must be shaped by an appreciation of the nature of American exports. Approximately 75 percent of U.S. manufactured exports are capital goods and industrial supplies. We will not expand our export opportunities in these areas simply by convincing Japan to do away with the large retail store law. There may be merit in doing that, but we also need to find a way to help American producers become permanent participants in Japanese supplier networks. Our guess is that these networks are the dominant factor in Japan's strikingly low propensity to import manufactured products, a phenomenon that several recent reports have underscored.

In terms of the level of importance for those issues identified by NAM which were not clearly addressed by the U.S. Government, the top three issues are: (1) investment policies and practices in Japan whereby U.S. investors in Japan have not been able to operate with the same freedom as Japanese investors in the United States, (2) the misuse of the Japanese patent system which may deny the legitimateintellectual property rights of U.S. companies, and (3) Japanese administrative guidance whereby the wishes/policies of Japanese bureaucrats to Japanese business can have the effect of aggravating the U.S.-Japan trade imbalance by channeling resources to industries that compete with U.S. industries.

As for the seven areas of the U.S. economy identified by Japan as impeding U.S. competitiveness, respondents clearly saw merit in the following issues: (1) inadequate training and education of the U.S. workforce, (2) U.S. corporate behavior with its emphasis on short-term strategies, and (3) the low level of U.S. export promotion in both the public and private sectors. They clearly viewed, however, other issues raised by the Japanese such as U.S. government regulations or corporate investment activities as having far less merit in terms of explaining our trade difficulties with Japan.

I have only touched upon the top issues identified in the preliminary results of our survey. We would be glad to share with this Subcommittee the final results when they are completed.

## CONCLUSION

The SII talks deal with market access and this is clearly a crucial element of U.S. trade policy. But market access is only one element of the trade problem, and market access initiatives can only be genuinely successful if coupled with aggressive actions in other areas. There needs to be a strong U.S. export promotion program, including a healthy Eximbank and a minimum of export controls. A system of relatively stable exchange rates needs to be maintained, one that reasonably reflect the competitiveness of the countries in the trading system. The LDC debt problem needs to be credibly addressed. And above all, changes in U.S. law and policy generally must take account of the need to promote U.S. competitiveness. Otherwise, we run the risk of nullifying in some other way the progress that can be achieved through the implementation of the 1988 Trade Act.

Thank you.

Attachment.

## U.S.-JAPAN TRADE RELATIONS—AN NAM INVENTORY OF CONCERNS

(WHICH ACCOMPANIED THE NAM STATEMENT ON JAPAN AND SUPER 301)

1. *Administrative Guidance.* Every effort should be made to ensure that administrative guidance is not used to discourage imports, even in sector or product areas, such as satellites and supercomputers, where Japan is in the process of building major industries.

2. *Depressed Industries.* If the notion of comparative advantage has any meaning, it is that countries ought to be willing to import those products in which their own firms are not competitive. Japan's special legal provisions for 22 "structurally depressed" industries tends to nullify this essential component of an open trading system. In this context, trade distorting measures should be eliminated.

3. *Intellectual Property Protection.* The adequacy of Japan's protection of intellectual property rights has been challenged in two important ways One set of problems relates to specific features of Japan's patent system, such as the length of time it

takes for Japan's patent office to examine applications and issue patents. Another, potentially more serious charge, is that the system can be easily misused by Japanese nationals. to effectively deny the legitimate intellectual property rights of U.S. companies. This has been done through spurious interventions designed to delay the issuance of legitimate patents and through multiple filings by Japanese firms, the primary purpose of which is to force U.S. patent holders to enter cross licensing agreements with them. Both governments should review both kinds of problems.

4. *Investment Policy.* On the assumption that both U.S. and Japanese companies are active in both countries, there should be review of Japanese investment policies to ensure (a) that they do not operate to the disadvantage of U.S. producers with respect to their ability to operate with as much flexibility as their Japanese counterparts in both countries and (b) that they are not used to achieve questionable collateral Japanese objectives, such as, access to proprietary information.

5. *Japan's Customs Procedures.* The Government of Japan should make every effort to ensure that Japan's custom's procedures do not present unwarranted burdens to importers.

6. *Japan's Distribution Systems.* There is reason to believe that the Japanese distribution systems are themselves a serious trade barrier. To the extent that these systems produce price levels dramatically different from those prevailing in the rest of the world, they have the effect of significantly reducing Japan's potential consumption of imported products.

7. *Japan's High Savings Rate.* Japanese macroeconomic policies should be modified to encourage more consumption, i.e., a higher living standard in Japan.

8. *Japan's Tied Aid.* As the world's principal provider of foreign aid, Japan should reduce the amount of aid tied to Japanese exports. Tied aid only exacerbates the serious imbalances in the trading system (a) by increasing Japan's global trade surplus and (b) by making it more difficult for the United States and others to sell to developing countries. This issue needs to be addressed not only in terms of Japan's stated policies but also in terms of the persistent pattern of subtle linkages between Japanese contractors and project coordinators in countries benefiting from Japanese aid.

9. *Japan's Violation of Trade Agreements.* The U.S. Government has already determined that Japan is not in full compliance with the 1986 Semiconductor Agreement. U.S. negotiators need to emphasize that one-hundred-percent commitment to the obligations of existing trade agreements, as well as any that may be negotiated in the future, is a sine qua non of improved trade relations both politically and economically.

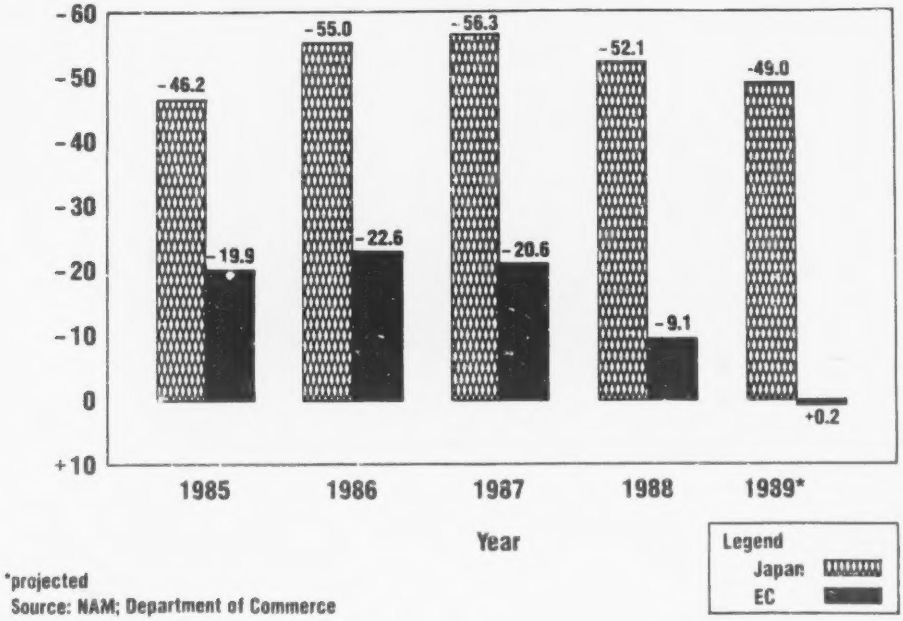
10. *Public Procurement.* Given the large sums likely to be spent by Japan on public procurement in the coming decade, the Government of Japan should review its procedures to ensure that foreign firms have the same opportunity to bid on Japanese public procurement projects as Japanese firms and to be successful.

11. *Relative Absence of Intra-Industry Trade.* Further analysis should be undertaken in Japan to discover why Japan does not engage more in intra-industry trade with a view to encouraging such trade.

12. *Standards & Certification.* Similarly, every effort should be made to ensure that standards, testing and certification requirements are focused solely on issues such as health and safety and are not used as import barriers. Further, the United States and Japan should explore the possibility of an agreement providing for mutual recognition of national testing and certification procedures.

(APPROVED BY THE NAM INTERNATIONAL TRADE POLICY COMMITTEE AND THE INTERNATIONAL INVESTMENT AND FINANCE COMMITTEE, MAY 10, 1989)

U.S. Trade Deficit with Japan and the European Community 1985-1989



*projected
Source: NAM; Department of Commerce

PREPARED STATEMENT OF T. BOONE PICKENS, JR.

Mr. Chairman and members of the Committee, my name is Boone Pickens. I appreciate your invitation to testify here today.

I am General Partner of Mesa Limited Partnership based in Dallas, Texas. I am chairman of a private investment firm called Boone Co. which also is based in Dallas.

I commend you for holding this timely hearing to identify the nature and the scope of the structural impediments that preclude American entrepreneurs from achieving legitimate entry to investment opportunities in Japan.

Boone Co. has a significant investment in Koito Manufacturing Company Ltd., a Japanese automotive lighting company. The treatment we have received thus far by corporate Japan contrasts sharply with the treatment accorded Japanese investors in the United States, and it is symbolic of the current trade relations between our country and Japan.

The Japanese quest for world economic dominance is evident in the treatment that Boone Co. has received from the Board of Directors of Koito. At issue is what I call silent trade barriers that prevent Americans from entering Japan's markets, while the Japanese are free to invest in the United States at will.

Boone Co.'s position is truly unique because, as foreigners, we have acquired such a large position in a Japanese company. The reaction from the Japanese business and financial community has been particularly intense. We initially purchased 20 percent of Koito's stock in March of this year. In August of this year, we increased our holdings to 26 percent.

Despite our position as Koito's largest shareholder, our requests for even the most rudimentary financial and operating information about the company, which would be granted as a matter of course for shareholders in this country, have been received with curt and evasive responses. That is, responses that were inappropriate for any stockholder, let alone the largest one. The most critical factor in making sound investment analysis is the ability to obtain accurate, economic information on a timely basis. Nevertheless, the entire system in Japan is geared toward the denial of a meaningful flow of information to shareholders.

Moreover, our attempts to obtain representation on the company's board of directors have been resoundingly rejected by the board members. On the other hand, the next largest shareholder, Toyota Motor Co. with 19 percent ownership, has at least three seats on the board and appoints key operating management.

Mr. Chairman, I am not an expert in foreign affairs or trade relations. However, I do travel quite extensively, and I speak to many different groups of people. During my travels, I have sensed that my frustrations in dealing with corporate Japan are not unique. Many Americans are frustrated and extremely concerned about our own economic future in light of the significant advances by the Japanese in recent years.

These observations are consistent with the results of a poll conducted by Louis Harris and Associates for Business Week during the week of July 7-11, 1989. This poll of 1,250 adults nationwide asked a number of questions about the U.S. trade deficit with Japan and economic relations between the two countries.

The question was asked, "If you had to say, which do you now think is a more serious threat to the future of this country—the military threat from the Soviet Union, or the economic threat from Japan?"

The answer provided an incredible statistic.

| | |
|---|---|
| Military threat from the Soviet Union | 22 percent |
| Economic threat from Japan | 68 percent |
| No difference | 5 percent |
| Not sure | 5 percent |

By a margin of three to one, the American people think the economic threat from Japan poses a greater risk to the United States than the Soviet military.

Japan has the second largest economy in the world next to the United States, and yet it continues to maintain a closed system. The Japanese roam the entire world, trying to invest with their vast capital, but there is only one place—the United States—where they have a truly open invitation. Ironically, they are unwilling to provide access to foreigners seeking similar opportunities within their markets.

There is no doubt that the United States economy is the most open in the world. Investors, foreign or domestic, need only to comply with our Federal and state securities laws in order to freely participate in our equity markets. Our laws are uniformly applied in principle, custom and usage. Foreign investors are not at a competitive disadvantage.

This holds true for the Japanese who face no real barriers to entry into the United States capital markets. Sony Corp. purchased CBS Records in 1987 for $2 billion; Bridgestone Corp. of Japan bought Firestone Tire and Rubber Company for $2.65 billion in 1988, and this year Sony Corp. bought Columbia Pictures Entertainment Inc. for about $3.4 billion.

Japanese companies are not only purchasing control of our corporations, but they are also buying significant amounts of real estate property throughout the United States. Just last week, Mitsubishi Estate Co. agreed to pay $846 million for a 51 percent interest in the Rockefeller Group Inc., which owns Rockefeller Center and other buildings in mid-town Manhattan. The most prestigious business address in America is now controlled by the Japanese.

This is only the latest of many billions of Japanese purchases of American real estate, from Hawaii, to Los Angeles to New York. Nippon Life Insurance and Daiichi Mutual Life Insurance, both shareholders of Koito where we now own 26 percent, are two of the Japanese financial conglomerates using huge cash surpluses to increase holdings of American real estate.

These Japanese companies aren't limited to a minority stake in U.S. corporations; many purchase 100 percent of the outstanding shares of the company and gain complete control. Because of interlocking ownership, an American purchase of complete control of a Japanese concern would be virtually impossible.

Even the one Japanese law designed to put some limits on interlocking ownership has been watered down in the last few years. Until 1982, no more than 70 percent of the outstanding shares of all publicly traded Japanese companies could be held by 10 or fewer shareholders. That standard has been exceeded by Koito, but the limit was temporarily changed to 80 percent. This is a structural impediment.

Japan's anti-foreigner nature was put into play more than 20 years ago. A prime example can be cited in Toyota's articles of incorporation. In 1968, Eiji Toyoda, then president of Toyota Motor, announced at the general meeting of shareholders that "directors and auditors of the company should be Japanese." The announcement was challenged in court, but Toyota insisted that this stipulation was necessary so that the company could defend itself from being dominated by foreign capital. In 1975, the motor company formally deleted this portion from its corporate articles, although it is still a practiced policy under Eiji Toyoda who now serves as chairman of the board.

Thus, as the United States maintains an open economy, Japan vigorously maintains a closed system. The cartel members who run Japan's economy will take whatever action necessary to ensure the maintenance of the status quo and their own economic interests.

Koito management acts in concert with other members of the cartel to ensure that the annual shareholders meetings of all major public companies in Japan are scheduled on the same day. This dilutes shareholder attendance and participation, and it prevents shareholders from using the annual meeting as a forum to obtain information.

A select few members of the business and financial community exercise dominant control over the policy of Japan's major, public companies. This small group can cause one company to execute a contract on less than favorable terms in order to benefit the parent company. Such a cozy system enables incumbent managers to reward one another with favorable contracts between companies, without regard to the impact on dividends or the shareholders. The cartel-like management uses these relatively low-cost contracts to undercut competition in the world market and thereby achieve its ultimate goals—increased world market share. We have all read recent examples of bid rigging by Japan's major construction companies.

The Japanese themselves are aware of this system. A recent article in a leading Japanese business journal, the Nikkei Sangyo Shimbum, confirms my view. An unnamed Japanese auto parts manufacturing executive is quoted as saying "unlimited demands from trading partners who are major shareholders are a headache to us." The article further states, "Their power as major shareholders is far greater than that of trading corporations. If not properly handled, eventually the heads of corporations would be replaced. In the short term, the merit of mutual interlocking shareholding is that the shareholder company can acquire shorter delivery time, stable supply of quality products at lower prices by maintaining long-term, stable trading relations. Shareholder companies have the right to intervene in the operations of the companies in which they have stakes in such means as technical guidance to improve productivity. Even though the dividends are small, the system fully pays off, or brings even greater benefit." (October 5, 1989)

This "greater benefit" to Japan is nothing more than the absence of competition. For example, Toyota never has any problem obtaining delivery of its auto parts lighting system, because it vigorously exercises control over the business affairs of Koito. The present chairman of Koito worked for Toyota for more than 30 years prior to taking the Koito position. Other top officials at Koito have also been employed by Toyota. There is very little question that the incumbent managers of Koito owe their loyalty to Toyota to the exclusion of other shareholders.

I was initially as much puzzled as I was frustrated about the Koito Board of Directors' response to Boone Co.'s investment. I did not understand why there was so much animosity and resistance to my efforts. I made it clear that I was not interested in anything remotely related to greenmail. To the contrary, I have always said and still explain that my sole reason for the purchase of the Koito stock was to make a profitable, long-term investment. Japan is a growing economy, and it should provide a fine return on investment.

Boone Co. remains a minority shareholder in Koito and has no prospect of acquiring a controlling interest. The cartel can always outvote me, and the complex system of cross-ownership of shares in Japan prevents Boone Co. from ever contemplating purchasing 100 percent of Koito. After analyzing all of these facts, I came to the conclusion that Koito managers were resistant to my investment because I represented a foreign threat to their stable, closed cartel-like system. They could not afford to let an American on the inside for fear of what I might discover.

I have twice written Koito's large shareholders, and I have not yet received one response. I have submitted those two letters for your review. I also have communicated with Koito's individual shareholders, and I have received replies from 200 stockholders who hold 959,299 shares. Of those who expressed an opinion, 88 percent have been supportive of my efforts. I am also submitting some of those responses. One shareholder stated, "I will support your fighting entirely. I ask you to cast away the managers who neglect the rights of stockholders." And another said, "I think that it is the proper right of a shareholder to request increase of interim dividend, and Koito owes an obligation to distribute its profits to its shareholders. I give my wholehearted support to activities of your company."

Mr. Chairman, the problem is not limited to the closed system maintained by Japan. In dealing with the Japanese, you must be concerned with more than the inability of Americans to penetrate the barriers in the Japanese economy. You must also be concerned about the power of the Japanese to exert their dominance on the world economy.

I urge you to examine the extent to which the Japanese are exporting goods and services. The Japanese have exported to the United States roughly $88 billion of goods and services from July 1, 1988 to June 30, 1989. Of that total amount, three major shareholders of Koito account for 18 percent or $16 billion. The chart attached as Appendix I illustrates that this is how the cartel works.

The automotive and electronics industry provides a good example of my point. Toyota, Nissan and Matsushita—which together own 30.2 percent of Koito—are among those companies that contribute significantly to the huge trade deficit that this country faces with Japan. Initially, the Japanese entered this market merely by achieving significant levels of retail sales of automobiles and electronic products.

In recent years, the Japanese have aggressively entered the manufacturing business in the United States by opening their own production facilities. Before we know it, the Japanese will have imported their system of cartel-manufacturing to the United States. They are keeping American competition out of Japan, and at the same time are exporting their system of cartels into the United States in contrivance of our anti-trust laws. This system is described in an article from the Nihon Keizai Shimbun (the Japan Economic Journal) which appears as Appendix II.

If Toyota's financial position is enhanced through its all-powerful relationships with the Koito's of Japan, what is Toyota, Honda or Nissan doing with its same Japanese-owned suppliers who have followed their plants to the United States?

For the past 100 years, our economy has been without trusts or cartels. We cannot permit the Japanese to sneak theirs through the backdoor. Busting Japan's trusts is not only essential to free trade, but with more and more Japanese investment in the United States, it is critical to the preservation of our own free enterprise system of open competition.

The last few months have been particularly interesting for me as I have always been challenged by unique investment opportunities. I have never minded the competition, and I have come to realize that the Japanese use two rule books, one of which says they win and the other which says we lose. If we continue playing on Japan's unlevel playing field, I am convinced that the United States will not remain an economic leader in the emerging global economy of the 1990s.

In closing, I want to thank you, Mr. Chairman, as well as members of the committee and your respective staffs. I appreciate the difficulty of the task that you have undertaken. It has taken us several years to realize the magnitude of our trade problems and the enormity of the stakes involved. Your efforts are a critical first step in mapping out a strategy for opening the world economy to each potential entrant.

Finally, I urge your support of two legislative initiatives that I believe address the problem at hand. First, I understand that Senator Baucus is considering the introduction of legislation that would grant a cause of action under Section 301 in the event of a failure of negotiations under the Structural Impediments Initiative. I endorse this concept, and I urge you to work with Senator Baucus to ensure its passage. Second, Rep. Don Sundquist (R-TN) recently introduced H. Con. Res. 216, which urges the reduction of barriers to Americans trading with or investing in Japanese companies. I have found that the Japanese listen closely to members of the United States Congress. Therefore, I think a similar resolution in the Senate could have a positive impact.

Thank you for the opportunity to express my views.

Enclosures.

## APPENDIX I.—KOITO MANUFACTURING COMPANY LTD.—SHAREHOLDERS THAT EXPORT TO NORTH AMERICA

| | Toyota Motor | Nissan Motor | Matsushita Electric Industrial |
|---|---|---|---|
| Profit before tax | 569,888 | 177,974 | 249,494 |
| Gross sales | 7,190,590, | 3,580,110 | 4,074,674 |
| Total assets | 6,316,191 | 3,117,499 | 2,928,861 |
| Exports amount | 2,462,581 | 1,462,839<br>(only cars) | 1,378,436 |
| Ratio of the export to North America to the total export | 55.0% | 47.0% | 36.2% |
| Amount of export to North America | 1,354,419 | 687,797 | 498,993 |

| | Toyota Motor | Nissan Motor | Matsushita Electric Industrial |
|---|---|---|---|
| Share among the total Japanese export to North America | 9.7% | 4.7% | 3.7% |

Notes:
1. All figures represent million yen.
2. Figures for Nissan and Matsushita are based on the period beginning April 1, 1988 and ending March 31, 1989. The figures for Toyota are based on the period beginning July 1, 1988 and ending June 30, 1989.
3. Total amount of the Japanese export is for the period beginning April 1, 1988 and ending March 31, 1989. During that time total exports to North America were valued at 13,482,621 million yen, and the total to U.S. were valued at 11,846,329 million yen. For the period July 1, 1988 through June 30, 1989, total exports to North America were valued at 13,964,314 million yen and the total to the U.S. were valued at 12,280,873 million yen.
4. The following sources were used to compile this chart:
   a. The Annual Securities Reports 1989 for Nissan, Matsushita, and Toyota.
   b. The Summary Report on Trade of Japan 1989 (prepared and distributed by Ministry of Finance.)

## APPENDIX II.—NIHON KEIZAI SHIMBUN (JAPAN ECONOMIC JOURNAL) OCTOBER 20, 1989 CIRCULATION: 2,713,000

(FULL TRANSLATION)

Structural Adjustment    Part I.—Power of Groups—7

Presidents of four automobile parts makers—Nissan Shatai Co., Ltd., Calsonic Corp., Aichi Machine Industry Co., Ltd. and Tokyo Sokuhan Co., Ltd.—were all changed at the end of this June. All the four companies are members of the "Takara-kai," made up of Nissan Motor-affiliated parts companies. All the four new presidents have been sent from Nissan according to the established custom.

An ex-Nissan official who stepped down from presidency at the end of this June says, "All we can do is to just recommend our choice. Everything is decided by Mr. Yutaka Kume, president of Nissan. I hear that a person who was not the initial choice was appointed president of Kanto Seiki Co., Ltd. this May, since the top personnel change was got wind of in advance. Therefore, we had no idea who would be sent to the four parts makers."

Executive managing directors, managing directors or directors of Nissan have been customarily named presidents of major Takara-kai member corporations in accordance with the scale of these corporations. Their tenure is four years in two terms. At the end of their tenure, they will retire without becoming chairman of the company. This is an unwritten rule of the Takara-kai. The top personnel affairs of these Takara-kai member corporations are completely under the control of Nissan.

Such Nissan-affiliated parts makers' groups as the "Takara-kai" and the "Shoho-kai" are like lifelines for Nissan. A car is assembled using more than 30,000 parts. Cars cannot be completed if any one of the conditions, including quality and the appointed date of delivery of parts, is not satisfied. Therefore, the strength of parts affiliate is directly reflected in the competitiveness of Nissan. Against this background, it is important to maintain strong parts affiliates. To this end, along with the possession of shares of the affiliated parts makers, sending Nissan executives to these companies is one of the most important means.

According to the estimation of the industry, Japanese automobile makers such as Toyota and Nissan manufacture approximately 30 percent of their parts for themselves, while General Motors Corp. and Ford Motor Co. manufacture more than 50 percent for themselves. The gap, more than 20 percent, is produced by Japanese affiliated parts makers.

In some cases, Japanese complete car assemblers have made their affiliated parts makers their wholly-owned subsidiaries, like one division within GM or Ford, by processing the majority of the shares of these parts makers.

In many cases, however, complete car makers hold about 30 percent of the shares of their affiliated parts makers at the most.

Yet, complete car makers send their officials as presidents or directors of their affiliated parts makers, and incorporate these makers into their parts makers' groups which are practically under their control. They even unify labor unions. The result is the affiliate groups special to Japan, which include not only capital relations but also other management matters.

Complete car makers have pressed their affiliated parts makers for discounts in return for stable and quantitative orders they give. Parts makers have met such requests from complete car makers even at the cost of profit and dividends. In other words, complete car makers, which are shareholders of these parts makers as well, have tolerated "low" directors, discounts and stable security of parts—"invisible dividends."

This is an established "business rule" adopted not only by the automobile industry but also by the overall industrial circles in Japan. This has made great contributions to the enhancement of international competitiveness of Japanese corporations.

However, this affiliate system of Japan appears to be a system ignoring the interests of shareholders to overseas shareholders who cannot enjoy such "invisible dividends." It seems to overseas parts makers, who are not the members of the Takarakai, to be a very exclusive trading form.

Boone Co., the chief shareholder of Koito manufacturing Co., Ltd., requested Koito at the end of September to increase the interim dividend for the period ending in September, 1989 from Y4 per share to Y7 per share.

Kanji Ishizumi, a lawyer representing Boone Co., says, "Considering the Koito's dividends, which are lower than those of American automobile parts makers, it is clear that Koito is giving Toyota such invisible dividends as 'discounts' and 'observance of appointed dates of delivery.' It is unfair to the shareholders who, unlike Toyota, cannot get profit other than dividends."

If Koito were a totally owned subsidiary of Toyota or an unlisted corporation, it would be allowed to have any affiliate relations. However, it should give the top priority to the interests of shareholders as long as it is enjoying merits of stock listing, including the fund-raising at low interest rates through the market," he adds.

A parts maker president says, "If it had not been Mr. Pickens that cornered Koito shares, serious discussions would have been developed about the affiliate relations in the Japanese automobile industry . . . ." He is disappointed that the focus of the Koito issue has shifted to whether or not Mr. Pickens is a greenmailer. The real aim of Mr. Pickens has not been made clear yet. However, claims of Mr. Pickens are skirting along the heart of the Japanese affiliate system as a whole.

A Nissan director says in a puzzled way, "We used to be asked about our relationship with our affiliated parts makers by GM and Ford. Before the Koito issue surfaced, I had told them that our affiliated parts makers were something like their parts business divisions and that such parts makers were part of Nissan. However, now I cannot make such a reply. I wonder how I can explain our relationship with our affiliated part makers."

A Toyota director says, "It may be the time we should review the establishment of a legal system that will streamline the relationship between parent companies and their subsidiaries, allowing a holding company system. Then, issues like the Koito case would not get bogged down this far."

Toyota has realized through the recent incident that the affiliated relations, which are extremely vague in the light of the logic of capital centered on the corporation system, are about to be at a turning point. A major automobile maker top executive notes, "Japanese manufacturing industries which greatly depend on affiliated makers would be severely damaged if legal defensive means against hostile mergers and acquisitions (M&A) were not firmly established." The idea to revive the holding company system has been rapidly spreading among Japanese corporate managers.

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BOONE CO.,
*Dallas, TX, September 18, 1989.*

Subject: Koito Manufacturing Co., Ltd.,
Request for Increase of Interim Dividend

Dear shareholder: Boone Co. has sent a letter to Koito requesting that its Board declare an increased interim dividend for the current fiscal term. A copy of the letter is attached, along with a Japanese translation for your convenience.

As you are aware, Boone Co. is the largest shareholder of Koito with 20.2% of the outstanding shares. As a large shareholder, we have taken several steps to attempt to participate in the management and policies of Koito and to advance the position of shareholders. The request for an increased interim dividend is made as a part of these ongoing efforts.

As fellow shareholders, I hope that you will support this request and voice your support to Koito. All shareholders will be equally benefited by these actions. If you have any comments, opinions or questions, please contact me directly or through our below mentioned attorney within ten (10) days of receipt of this letter.

Mr. Nobuo Miyake
Attorney-at-Law
Miyake, Hatasawa & Yamazaki
Sogo Nagata-cho Bldg.
11-28, Nagata-cho 1-chome,
Chiyoda-ku, Tokyo 100

Thank you for your interest and attention to this matter.

Sincerely,

T. BOONE PICKENS.

Attachment.

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BOONE CO.,
*Dallas, TX, October 5, 1989.*

Re: Koito Manufacturing Co., Ltd.,

Dear Shareholder: On September 18, I sent a letter asking for your support for a proposal to Koito to increase its interim dividend. More than 10 days have lapsed since you received the letter, the period in which I requested your comments, opinions or questions. However, I have not received any response from you.

Boone Co., the largest shareholder of Koito, again urgently requests your support for the increase of interim dividends. I also again solicit your comments and opinions on whether or not you, as a shareholder of Koito, will support this request. As you recognize, an increased dividend would benefit all shareholders on an equal basis. If I receive no answer from you, I can only assume that you, for some reason, object to the increased dividend.

In a recent letter to Boone Co., Koito speculated that proceeds received by Boone Co. from the dividend would flow to Azabu. This assertion is totally incorrect. As a properly registered shareholder, Boone Co. would receive and retain its share of dividends just like your company—no part of the dividend would directly or indirectly be paid to Azabu.

Clearly the right to receive dividends is an important component of a shareholder's ownership interest in a company. All shareholders, regardless of their length of ownership or size of holdings or cost basis, share equally. Japanese listed companies are known for paying very low dividends. This occurs because Japanese companies have clung to a custom of basing dividends on the par value of a stock. In most other international markets dividends are based on the market value of the stock or the net profits realized by the company, resulting in much higher average dividends to shareholders.

The valuations of Japanese stocks have clearly been influenced more by the mutual cross shareholdings system than by returns to shareholders. By "locking away" shares in friendly hands, Japanese companies reduce the number of freely traded shares. While this scarcity has contributed to higher stock prices, it also dilutes the influence of shareholders who are not part of the cross holding group.

When I combine the cross shareholding system with the unwillingness of major shareholders to support higher dividends, I must question whether the major holders receive benefits not shared be all shareholders. Do the business relationships and transactions between cross holding companies provide direct or indirect benefits to certain shareholders? How do you reconcile the potential conflicts between your position and interest as a shareholder and your interests as a party engaged in transactions with Koito? And finally, how are the interests of shareholders who have no business relationship with Koito protected?

It is ironic that Japanese companies are seeking to protect and cling to this system at the same time that they are expanding their participation in foreign markets. Just last week, Sony announced two major acquisitions in the United States totalling $3.6 billion. It was also reported in the Nihon Keizai Sangyo Shimbum that Sony will, for the first time, appoint foreigners to its board of directors. The same article pointed out that only 3% of Japanese companies have foreigners on their boards, compared to 21% for North American companies, 34% for European companies and 41% for Asian companies, excluding Japan. The discrepancy in these numbers dramatically illustrates the closed nature of Japan's corporate system. I strongly ask your support for our continuing efforts to obtain board representation at Koito.

As you have read, Boone Co. has determined not to call for a special shareholder meeting at this time, although we will likely call for one later. I believe that a special meeting would not be productive at this time because shareholders have shown no willingness to fairly consider our proposals. Through our letters to you and others, I hope to establish a constructive dialogue that will lead to legitimate consideration of our ideas and proposals.

Therefore I again ask that you respond to this letter with your comments and opinions, whether positive or negative. Please respond by October 13, in either English or Japanese, to either:

Boone Co.
2600 Trammell Crow Center
2001 Ross Avenue
Dallas, TX 75201 U.S.A.

or

Miyake, Hatazawa, Yamazaki Law Office
Sogo No. 10 Bldg.,
1-11-28 Nagata-cho, Chiyoda-ku,
Tokyo 100

Thank you for your interest and attention to this matter. look forward to hearing from you.

Sincerely,

T. BOONE PICKENS, *Boone Co.*

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BOONE CO.,
*Dallas, TX, October 11, 1989.*

Dear Shareholder: As you are well aware, Boone Co. sent a letter dated September 18 to Koito Manufacturing Co., Ltd. ("Koito") requesting that its Board increase the interim dividend for the current fiscal term. Boone Co. also sent two letters to its major shareholders asking for their support for the above proposal. Attached herewith for your reference are copies of the above three letters in Japanese.

In responding to our request which was made solely for the benefit and in the interest of all Koito's shareholders, Koito has taken but a nominal position stating that the issue will be discussed at the Board meeting toward the end of November. Judging from the past record of Koito's management, however, we doubt that Koito will duly consider our sincere proposal.

Needless to say, the right to receive dividends is the most important component of the shareholder's rights. As we indicated in our letter to Koito, Koito has sufficient funds to increase its interim dividends for this term. As fellow shareholders, we hope that you will support out request and voice your support to Koito. Also, we would appreciate your comments an opinions by writing to us at the following address:

Boone Co.
c/o Miyake, Hatasawa & Yamazaki
Sogo Nagata-cho 1 chome,
Chiyoda-ku, Tokyo 100

Thank you for your interest in and attention to this matter. I look forward to hearing from you.

Sincerely,

T. BOONE PICKENS.

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OUR FILE NO. 1385-1, 83-13

## SUPPORT

a. *(Supports showing wills to be represented by Mr. Pickens)*

1. I own 10,000 shares. As I agree to your opinion, I can have you as a nominee of my shares. I am looking forward to your reply.
2. I will trust to you for the performance.

3. Concerning the captioned case, I respect your opinion and support its gist. Therefore, I will trust to you for the performance. Do your best efforts.
4. I will trust to you for the performance concerning the requirement of higher amounts of interim dividends.
5. I received your letter today, October 16 and read it with thanks. Requirement of increasing the dividends should be done as soon as possible. I will trust to you, Mr. Pickens entirely for the performance and wish you to achieve it. Do your best efforts.
6. I entrust you with request for the increase of interim dividends of Koito as you requested.
7. I entrust you with request for the increase of interim dividends of Koito as you requested.
8. I will trust to you for this matter.
9. I thank you for your day-and-day efforts. I will trust to you for all the performance. Best regards,

b. *(Criticism against Koito's neglecting its shareholders)*

10. I am one of the stockholders of Koito. I think your assertion just due. I agree to your requirement concerning dividends on proposal entirely. Do your best in continuing your assertion. I feel deeply the necessity to amend the way of holding general meeting of stockholders which is exclusive or formal.
11. I do expect the rights of stockholder to be more strengthened. I require the due dividends to be paid for the stockholders after incompetent directors is cast away not a moment. Fight a good fight!
12. I will support your fighting entirely. I ask you to cast away the managers who neglect the rights of stockholders not a moment.
13. I read your letter. I have known the outline through mass-media. And I am amazed at the infantile and unblushing reaction of Koito as follows, which might not be the acts of the listed company and which neglect shareholders' right:
    (1) refusal of the request to dispatch the directors from you who is a first stockholder on the list
    (2) refusal of your request to increase interim dividends
    (3) And also, irresponsibility of Koito's officers declaring the stock price of Koito is 2,000 yen at most per a stock.

    Needless to say, shareholders would expect high dividend and high stock price and therefore the manager of companies should be bound to respond to such expectation. But it is made known that Koito is not conscious of its responsibility and duty and that Koito has been continued to be operated for private business by the group of the companies related Koito. I think your claims, requests and activities are all right and quite natural. Now, for very small shareholders, I expect you will breathe new life into the Japanese company and strongly claim shareholders' rights and interests.

c. *(Criticism against Japanese companies' neglecting their shareholders)*

14. I support your opinions completely. I was greatly indignant at Japan's tendency to ignore shareholders. I cannot admit issuance of shares to third parties made by "Miyairi Valve" the other day. Hold out, please. I will cheer you.
15. (I received your letter on October 16, and I wrote this reply promptly upon receipt of such.) I received your letter today at the first time. I did not receive your letter dated September 18. I thought nothing would be given to a small shareholder (with 1,633 shares). While thinking it is natural for a shareholder to desire much dividend, and it is unsatisfactory that besides Koito realizes great amount of profits, they are kept in the company and dividends are not properly distributed to shareholders and it is also unsatisfactory that per intent of large shareholders the rate of dividend is set at a low level, I had given up, because small shareholders (I have owned my shares since before World War II) has no power. I would like to give my whole-hearted support to you who are making efforts to make Koito to treat shareholders (especially shareholders keeping shares for long time) better. It was requested to reply in October 13, but this is impossible, for I received your letter today.
16. I read your letter dated October 11. I completely agree to your opinion as to increase of interim dividend. I am a small shareholder having shares since about 1957, and I have no relationship with Koito. I have the same opinion as you that profits distributed to shareholders are quite insufficient in Japan. Please claim your proper rights while removing closed nature of the board of directors. The above is my response though it is quite simple.
17. Response

(1) I agree with you if the increasing of dividends would be achieved.
(2) Japanese companies have treated their stockholders coldly from the ancient time. It is regrettable in comparison with U.S.A. This evil practice should be amended gradually.

18. I have examined the opinions of Boon Co. and Mr.Pickens carefully. Not only large shareholders but also I, as one of small shareholders, always angry that the Japanese managing style to neglect shareholders. I approve the request for the increase of interim dividends. October 10th 1989
19. I agree to your assertion entirely. I will assist you fully to develop the people so as to match the real internationalization to respect the stockholders. Do your best.
20. Though I understand that a dividends shall be based on par value, I think Koito strongly neglects its shareholders. Do your efforts. Good luck.
21. Thank you for your letters and I am sorry I sent this answer so late. I know your activity through mass-media. I am discontented very much with the bearing of Japanese companies to their shareholders and Japanese cross-holding system of shares. Therefore, I expect your action future and I hope that I cooperate with you. by So Kitami, Representative Director, Kitami Wood Co.
22. I support your opinion regarding the increase of interim dividends of Koito. Such Japanese traditional style of conduct that anyone do not anything without others' demand may be applicable to the case of the economical friction between Japan and the U.S. Do your best efforts to settle a precedent which indicates what is shareholders' rights under the capitalistic system and to make the situation of the present shareholders' rights in Japan to be accepted in the world. They say even a worm will turn. For us, you are an ally more reliable than "the Super Man."

d. *(Objections to small dividends of Koito)*

23. I have never examined the financial state of Koito but I hear that Japanese companies are low at their ratio of earnings to dividends and have rather tendency of down in these years. I expect that if you, at this time, analyze thoroughly what you assert, it might be very beneficial to the new development of Japanese economy.
24. I also think what you say is just correct. Why can't we be paid only such a small dividends? I cannot take even a dinner by such a small dividends. I have read your letter which my children brought to me on October 17. Best regards to Boone Co. I expect that Mr. Pickens will cherish the stockholders of Koito which is a good company. Best efforts!

e. *(Other criticism against corporate system in Japan)*

25. I require the increasing of dividend. It is regrettable that the directors of Japanese companies would refrain from asserting their opinions because of the consideration of the guard of their own status.
26. I require the increasing of dividend. It is regrettable that the directors of Japanese companies would refrain from asserting their opinions because of the consideration of the guard of their own status.
27. I agree to your policy.
    (1) I think your ideas concerning the increasing of the interim dividends of Koito are all important for the mere shareholders.
    (2) I support your assertion or action for the internationalization of Japanese stock market or of the listing of the company. Continue your fair assertions actively.
28. Boone Company
    Dear Mr. T. Boone Pickens.
    I have read your letter of October 11, 1989. I am a stockholder who has no relationship on trading with Koito.
    I agree to and support your assertions which you submitted to Koito later, that is (1) to require to take your seat in the Board of Directors of Koito, (2) to require the increasing of interim dividends. That is because your requirements are quite reasonable and legal. Do your best for the sound development of stock market in Japan. Best regards.
29. I require the increasing of dividend. It is regrettable that the directors of Japanese companies would refrain from asserting their opinions because of the consideration of the guard of their own status.

f. *(Conditional supports)*

30. I agree increasing the interim dividends if Koito increases its sales and profits. Do your efforts.

31. If there should be a stability in Koito's financial background, I agree to your requirement of increasing the dividends. I think the consideration for the rights of stockholders should certainly be paid.
32. Regarding increasing the interim dividends of Koito, I have no knowledge about shares and no information the management of Koito. I expect a increase of dividends. It is a matter of course that the company should be operate in a satisfactory manner and improved, and that realizes a high profit and fairly and properly divides.
33. I accepted the gist in your letter. I, as one stockholder, agree to the requirement of increasing the dividends. It, however, will be realized only after the decision of general meeting of the stockholders. I will support you so long as you continue to bring up Koito as the first stockholder on the list.
34. I am surprised to read the letter dated October 10th. I read on the paper that Mr. Pickens sent letters to the shareholders asking their support of his request for the increase of dividends. I thought that you sent to only the large shareholders. Although you said that the letters were send to the small shareholders like us, I have not received the letter. I support Mr. Pickens' opinions. I regret that the extra-ordinary shareholders' meeting, which was supposed to be called about October 10th, as I read on a newspaper of about August, was suspended to be called. The Nikkei Newspaper reported that a shareholder who has more than 33 percent of the shares can control a company as he or she wishes. Is that true? I think the stock price will rise if Mr. Boone Pickens joins the management of Koito. I expect that you, Mr. Boone Pickens, will exercise your ability in Japan by all means and I ask you not to make Koito (or Toyota) to purchase your shares, and not to forsake us. Do your best efforts. P.S. I received this letter on October 16.

g. *(Supports also expecting dividend by shares)*

35. I support the demand of Boon Company. How about stock dividend?
36. I have read your letter and understood your opinion. I have not received the letter dated September 18 as you mentioned. I think your opinion as a matter of course. You have a great power, while I am only a small fry. I can do nothing. I expect that Koito will grow more and more and I ask you we will be able to receive dividends or stock dividends even one more yen.

h. *(Desires for stock price to be risen)*

37. I agree to the amounts of the interim dividends to be increased. More than that, the stock price should be raised higher. The days of only a small trading of— Koito's stocks have been continuing. I presume that if there occur more than the purchase order of 500,000 stocks, there should be the price limitation soon. Instead of to urge Koito to increase the dividends from Y4 to Y7, the stock price should be raised to the extent of about Y7,000 or Y8,000. And thereafter, let Koito repurchase the suddenly-risen stocks on the condition that of their obtaining no profits.
38. If permitted to say to Koito, I think the current price Y4,000 per a stock is no good. The price should be more and more risen to Y7,000—Y8,000 per a stock. After that, it shall be O.K. There is "world-wide" Toyota on the back-ground of Koito. They say, We will never accept any director from exterior nor increase the dividends." But I think there is no other way but to have our stocks repurchased, if our stocks were such non-merit ones as our requirements would not be accepted.

    I expect that Koito is very fearful of the stock price to be raised to the extent of Y10,000 per a stock. Furthermore, I think it reasonable to solve this case as soon as possible to get American governors' assist. I encourage you at least to defeat Koito and Toyota. Finally, I wish you to absorb the 400,000 stocks of short selling as soon as possible.

i. *(A request for other shareholders' opinions)*

39. Re: request for increase of dividends

    (1) High dividends are good.

    (2) It was difficult for me to read and understand your extend six sheets of your letter. What are opinions of the shareholders who attend a shareholders' meetings? Is it enough to have baking of shareholders who attend shareholders' meetings?

*i. (Desires for Mr. Pickens being a director)*

40. I support your requirement concerning the increasing the interim dividends of Koito. I wish you to continue to assert the rights of stockholders, to participate in the operation of the company as a director and to do your best as a first stockholder on the list.
41. I agree to the request for increase of interim dividend. I support to participation of foreign directors in order to develop Koito and to guard shareholders' rights. Hold out and do not give up.

*j. (Without additional opinions)*

42. I am one of the shareholders of Koito. Your request for increase of interim dividend is fair and proper, so I hope you to push on your request to the last as a representative of us, shareholders.
43. I think that it is the proper right of a shareholder to request increase of interim dividend, and Koito owes an obligation to distribute its profits to its shareholders. I give my whole-hearted support to activities of your company. Hold out!
44. I support your request completely. Show your nerve!
45. I give my whole-hearted support to you. Best your efforts!
46. I hope you to do your best.
47. I cannot know exact figures, but I agree with you with regard to increase of interim dividend.
48. I am one of the supporters of your request for increase of interim dividend to Koito shares. I hope you to continue requesting increase of dividend and give us, shareholders, more benefits.
49. I agree to all of the contents of your letter. As one shareholder, I agree with you perfectly.
50. I agree. No specific opinion.
51. I agree with you.
52. I have read your letter. I also understand the situation from articles on newspapers and others. feel you are confronting several difficulties and troubles. I appreciate your more efforts and activities. I believe your intent must be understood some day.
53. I. agree with you.
54. I agree with you.
55. I agree with you.
56. I agree with you.
57. I agree with you.
58. I agree with you.
59. I agree with you.
60. I support your company.
61. I agree with you.
62. I agree with you.
63. I agree with you.
64. I agree with you.
65. I support your company.
66. Thank you for your letter. I also wish the interim dividends to be increased.
67. I support your strategy of increasing the interim dividends. I leave it to our best efforts.
68. Thank you for your letter reached me on October 16. Against it, I here response you immediately I agree with you. Best efforts.
69. I, as an stockholder of Koito, agree to your requirement to increase the dividends.
70. I agree with you. Bravo!!
71. I support your policy.
72. I support your policy entirely. Do your best efforts.
73. I wish the dividends to be paid at the adequate ratio of earnings to dividends.
74. I expect the dividends of Koito to be increased.
75. I guess your company's operating is going on well. Regarding to Koito's case, I think it a matter of course that if there were the increase of the operating profits, it should be restored for the stockholders.
76. I have ever wondered why the amount of the dividends is so low. Thank you for your letter. I do wish you to do your best efforts toward the increasing of the dividends.
77. I support and approve Mr. Pickens' request for the increase of interim dividends. October 17 1989

78 As one of shareholders, I think that the opinions of Boon Co. and Mr. Pickens is reasonable. I will also request for the increase of interim dividends.

79. I approve Mr. Pickens' request for the increase of interim dividends. I expect that he will compel Koito to respect its shareholders.

80. I agree increasing the interim dividends.

81. I read you letter regarding your request for the increase of interim dividends. Since I support your opinion, I expect your activities in Japan. I own only a few shares and I have no power. And this is my first letter that asking me to support a request an increase of dividends. Do you best efforts.

82. I, as one of the stockholders of Koito, agree to your requirement of increasing the dividends against Koito. We, stockholders, thank you for your best efforts so far. I wish you, as our representative, to continue the activity of requirement of increasing the dividends since now.

83. I agree with you. Do your best effort.

84. I agree with you. Do your best efforts.

85. I here response you concerning your letter related to Koito. I am a mere and general investor and have no particular relationship with Koito or Toyota. I support your requirement of increasing the dividends entirely because for a stockholder it is desirable to get more amount of dividends as possible.

86. I agree to your opinion. I understand what you say. I will trust to you entirely. I received your letter on October 18 for the first time.

87. I support your request.

88. It is a matter of course that you request for the increase of dividends as shareholder. I support the activity of your company, wholeheartedly.

89. Thank you for your letter. I understand your explanation. Thank you for your kindness. We get sick and read your letter for the first time. We ask you to help us. And ask you to inflate the stock price.

90. I think that your requests (request for the increase of dividends etc.) is right. Do your efforts. I expect you.

91. With respect to increasing the interim dividends of Koito, I support your request.

92. I wish the interim dividends to be increased and the extraordinary share holders' meeting. I ask you that you tell me some information if anything happens. I will fully insist upon my shareholder's rights.

93. I eager to get more dividends through your efforts. I expect you.

94. I agree to your requirement of increasing the interim dividends. Do you best efforts for many stockholders as a foreign director.

95. Re. requirement of increasing the interim dividends. I do wish as a stockholder that the captioned case should be dared to achieved on this occasion. I received your letter of October 16. I apologize you that I could not response soon.

96. According to your letter, it appears that you have sent the letter of trust to support the requirement of increasing the interim dividends but I have never received one. Then, I support you concerning the problem of the interim dividends and I will trust to you everything.

97. I agree to your requirement of increasing the interim dividends of Koito. I wish you to do your best for us stockholders as a foreign director. Best regards,

98. Thank you for your efforts. Since I do not have so many shares, I do not know all of the truth in this case. However, I think that your exercising of the shareholders' right is also useful for other shareholders. I hope we will get profit as the result of the faithful use of your rights.

99. I agree to the increasing of the dividends of Koito.

100. I agree with you entirely.

101. Reading your letter, I am afraid your efforts are very terrible. Do your efforts.

102. As I received your letter after the due date for submission, I have been at a loss what I should do. I will entrust my whole rights to you because I support your efforts to violate and improve the past evil custom. Do your efforts.

103. Dear sirs, I think the gist to treat the stockholders favorably quite due. But, unhappily I have already sold all the stocks away.

104. Thank you for your letter. I am sorry to respond to your letter so late. Regarding Koito, I agree with you. I ask you to do your best.

105. Dear sirs, I agree to your requirement of increasing the interim dividends of Koito.

106. I do not know the details, but I am convinced of Koito's bright future and I do require the interim dividends to be increased. I wish you and your concerns to make the best efforts in all sincerely in this project.

107. Thank you for your letter. I expect to get more dividends. Although we held more than 600,000 shares in the name of three persons, I do not know precisely how many shares I hold now. Therefore, please let me know whether or not I have enough shares to say something.
108. I support your demand of dividends increase. I have not received your former letter. I received only your letter on October 18. I have no idea to hold the shares for a long time.
109. I agree the increase of interim dividends.

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## PREPARED STATEMENT OF ERNEST H. PREEG

### U.S.-JAPAN ECONOMIC STRATEGY AND THE STRUCTURAL IMPEDIMENTS INITIATIVE

Mr. Chairman, I am pleased to come before this Subcommittee to testify on the subject of U.S.-Japan negotiations within the framework of the Structural Impediments Initiative (SII).

The SII can and should play a central role in bilateral negotiations during the coming year—and beyond in terms of implementing an agreed program of action. The agenda is comprehensive and the initial selection of items on the Japanese side constitutes the priority areas for moving toward balanced access to markets for imports and investment.

Thus far, however, the SII lacks credibility for achieving concrete results. A disappointing SII outcome next spring and summer, just as our current account deficit is projected to worsen, could lead to severe conflict in U.S.-Japan trade relations and increased pressures to restrict Japanese imports and investments in the United States. Such an outcome would be detrimental to both U.S. economic and foreign policy interests.

We should therefore seek means to strengthen the SII negotiating process so as to ensure a successful outcome. To this end, I would like to suggest four steps:

(1) *We need an integrated strategy for the U.S.-Japan economic relationship.* Such a strategy is the most urgent priority for U.S. trade policy at this time, but unfortunately we don't have one.

The strategy should have a clearly defined approach for reducing the trade imbalance and achieving comparable access to each other's markets, particularly with respect to high technology industry and foreign direct investment. It should relate bilateral negotiating objectives to complementary objectives in the GATT, the OECD, the G-7, and other forums. It should have a longer-term vision of how our two economic superpowers—at the leading edge of unprecedented technological change—can interact on the basis of fair and open competition, to the benefit of all nations.

It is in the context of such an integrated strategy that specific SII negotiating objectives should be crafted, and SII results assessed.

(2) *We need to distinguish, in the SII negotiations, macro economic policy coordination from structural impediments to market access, and pursue a distinctive plan of action for each category of issues.*

Macro economic policy adjustment is rightly included within the comprehensive SII agenda, in terms of Gramm-Rudman targets for the U.S. Federal budget deficit and the need for the overall consumption level to be lower in the U.S. and higher in Japan. Other macro policy instruments, however, such as interest rate and exchange rate policies, are not on the SII agenda. In any event, macro policy coordination rests primarily with finance ministers, principally in the context of G-7 deliberations. Thus far, the SII has little credibility in this area, such as in influencing U.S. actions to reduce the budget deficit.

What the SII could and should do with respect to macro policy adjustment is to provide a bilateral focus so that the United States and Japan can be more constructive in G-7 deliberations, since our two countries are the major causes of current disequilibrium in world trade. We need an agreed strategy for reducing our deficit and the Japanese surplus. What this entails is described in a recent article of mine in the *Journal of Commerce* (attached to this statement) The SII could help to develop such a strategy at the bilateral level, including specific objectives for a phased reduction of current account imbalances on a multilateral basis.

The issues relating to structural impediments to market access are more directly linked to trade policy, and we should press Japan to provide comparable treatment for U.S. exports and investment in Japan as Japanese firms receive in the United States. The five items on the SII agenda for Japan—land use, corporate linkages, exclusionary business practices, pricing mechanisms, and the distribution system—all deserve full deliberations, with the objective of a specific action program that would lead to comparable treatment of American and Japanese firms in a more open and competitive Japanese market.

(3) *We need to link SII market access objectives to parallel negotiating initiatives in various multilateral forums.*

Japan has obligations in the GATT, the OECD, and elsewhere, and we should exercise our rights and influence in those bodies, in concert with the European community and other trading partners, to press Japan on the same issues we are addressing bilaterally.

We should also pursue the issues on the SII agenda in any new structure for Asian-Pacific economic cooperation, which is being discussed by ministers today in Canberra. The problems of trade imbalance between the United States and Japan, and structural impediments to access to the Japanese market, have an important bearing on Asian-Pacific regional prosperity, and it should be a common interest of all participants at the Canberra meeting to have a successful result from the SII.

Parallel initiatives in multilateral forums should not be permitted to slow down the SII process, and they need not do so. We can adhere strictly to an agreed SII schedule while pursuing action-oriented initiative elsewhere. Some examples of this kind of linkage are:

(a) *Land use.* This is the most obvious link in which we will be pursuing agriculture trade liberalization in the GATT Uruguay Round in parallel with SII negotiations. What we need to do is to ensure that Uruguay Round agricultural deliberations focus heavily on the high-cost, trade-restrictive impact of the Japanese land use system. We should not let the Uruguay Round agricultural talks concentrate entirely on the U.S.-EC relationship.

(b) *Foreign direct investment in Japan.* The Uruguay Round also has a negotiating group on trade-related investment measures, and we should raise all appropriate aspects of Japanese institutional barriers to investment in a prominent way. In addition, the OECD Code on Liberalization of Capital Movements, to which Japan is a signatory, should be utilized. We should press Japan either to live up to its commitments or to consider explicit derogations, which Japan would be extremely reluctant to do.

(c) *Engineering/Construction services.* Both the Uruguay Round services sector negotiations and the OECD Code of Liberalization of Invisibles should be mobilized actively to focus on the inability of American companies to operate in Japan on a comparable basis with Japanese firms in this important sector.

An integrated bilateral-regional-multilateral approach would not only build greater pressures for Japan to be responsive, but it can make the process of change politically easier for Japan. Japan takes its commitments in multilateral forums seriously, and can find it more acceptable to take actions if they are based—or can be rationalized—on compliance with such commitments. Needless to say, a broader negotiating strategy, with relatively less bilateral concentration, would lessen negative political fallout on the U.S.-Japan relationship.

(4) *We need to specify our objectives in terms of both conditions of market access and quantifiable results.*

Debate over whether to seek changes in conditions of access or quantifiable results is a false dichotomy. Neither one by itself will work, and what we need is to have both. clear commitments by the Japanese Government on changes in the conditions of access should be the initial stage, by next July. Then a process of implementation is needed to monitor the actual results, based on close consultation between the U.S. Government and the private sector. One result of the SII next July should be to establish a bilateral monitoring mechanism to compile results and consider complaints.

With these four steps, the SII could play an important role in achieving a more balanced economic relationship with Japan.

This conclusion is based on the assumption that there is a process of change under way in Japanese society toward a more open and competitive economic system. The structure and workings of the Japanese economy are currently very different from ours, but I do not agree with those who believe that the differences are so fundamental and immutable that we must jettison our longstanding market-oriented approach to trade policy.

I believe, rather, that Japanese consumers and thoughtful Japanese in all walks of life are coming to see their self-interest in a more open and competitive economic environment. The political structure in Japan is facing growing pressures to take the necessary actions. The role of the SII and of U.S. negotiating strategy in other forums should be to support and accelerate this process of change. The SII, in this context. should be an exercise in public as well as private diplomacy. Our case rests on the premise of access for and treatment of U.S. companies in Japan equal to what Japanese companies enjoy in the United States. It is a good case and should be pursued with strong conviction.

A final comment is in order about the alternative to the SII approach for the bilateral trade relationship with Japan. Some criticize the SII as inadequate and advocate what can appear to be simpler and more effective, namely, the negotiation of bilateral trade targets, either by sector or for aggregate trade. Unfortunately, this won't work to the United States' advantage. It is most likely to lead to pervasive trade restrictions, such as existing voluntary export restraints on automobiles and the import floor price for semi-conductors. In both of these cases, Japanese companies have been the principal beneficiaries through higher profits that were reinvested to make Japanese industries even more competitive. Bilateral import restrictions, or the threat thereof, are also pushing Japan and its Asian trading partners closer together toward a potential, inward-directed regional bloc, while undermining the GATT multilateral trading system. In short, while the SII can be painstaking and slow to produce concrete results, it should work in the right direction of a more open, competitive trading relationship. A change of policy course to bilateral targets and restrictions, in contrast, will weaken U.S. international competitiveness at a time when it has become vital to our future economic well-being and national security.

THE JOURNAL OF COMMERCE, Thursday, October 5, 1989

**EDITORIAL/OPINION**

# Trade Is Key to Soft Landing

By ERNEST H. PREEG

Prospects for a "soft landing" for the U.S. economy could well depend on a trade adjustment strategy that does not now exist. Last week's meeting of finance ministers in Washington only confirms such an omission.

The U.S. trade deficit declined from $152 billion in 1987 to $120 billion in 1988, and may fall another $10 billion this year. However, the more broadly based current account deficit, which includes the growing debt service payments to foreigners, will likely level off in the $125 billion range this year. The International Monetary Fund projects an increase to $139 billion in 1990 due to the strengthened dollar. The IMF also projects that the Japanese current account surplus will increase from $72 billion to $90 billion, and the West German surplus from $53 billion to $57 billion.

A much lower U.S. current account deficit should be a key objective for a soft landing over the next year or two. The basic economic strategy should be to moderate domestic consumption, public and private, and shift the resources thus freed up to the export sector. The tricky part will be to implement sufficient "expenditure switching policies," such as exchange rate adjustment, so that reduced consumption will be offset by increased exports and import replacement. Otherwise, the soft landing could turn into a nasty recession.

So far, reduction of the current account deficit has not been spelled out in detail as a policy objective. The U.S. government does not even have an official projection for next year, and current account objectives have not played a prominent role in discussions among key finance ministers. There are three reasons for this.

First, a decline in the U.S. current account deficit must show up in other countries' accounts as reduced surpluses or increased deficits. The major surplus countries — Japan and the Federal Republic of Germany — project no such declines, and they are not inclined to change policies to achieve them. Countries with growing deficits, such as the United Kingdom and France, are even less disposed to discuss still larger deficits.

Second, finance ministers and central bankers are not keen to discuss exchange rate adjustments, which can unsettle financial markets. They normally prefer the objective of exchange rate "stability." Quite naturally, the finance ministers of the surplus countries are most resistant to exchange rate adjustment. "Adjustment," after all, implies appreciation of their currencies, which will bring howls from domestic industry.

Third, and perhaps most important, the U.S. economy was operating at full capacity through the spring of this year. There were no unused domestic resources to switch to exports. Therefore, discussion of a trade adjustment strategy would have been futile.

Now, however, there is a significant change under way in the U.S. economy. The private savings rate has increased from 3% in 1986 to 5.5% in the first half of 1989. The federal deficit should level off this year and will decline next year if the targets of the Gramm-Rudman-Hollings Deficit Reduction Act are even approached. Interest rates are steady. The economy is slowing down, particularly in the manufacturing sector, where trade adjustment will be concentrated.

In other words, the moment of truth has arrived for crafting a trade adjustment strategy. Resources are becoming available for the switch to exports.

The logical scenario is for slower growth in the United States to be accompanied by faster growth in economies of our trading partners so as to absorb more imports from the United States. Downward movement in U.S. interest rates will put downward pressure on the dollar, which likely will be necessary to give a renewed push to exports.

But were finance ministers, particularly those from surplus countries, up to the task when they gathered in Washington last week? Unfortunately, the answer was no. The ministers from the seven major industrialized countries issued a communique stating that "a rise of the dollar above current levels or an excessive decline could adversely affect prospects for the world economy," reaffirming their commitment to exchange rate stability despite the projection of an increased U.S. current account deficit.

Now is the time to formulate and implement a forceful, export-oriented trade adjustment strategy. The first step is to establish a rough target for reduction of the U.S. current account deficit, which is the appropriate measure of external imbalance. The United States should seek a decline of $50 billion to $100 billion over the next two to three years, compatible with slower domestic consumption. Our principal trading partners need to respond with corresponding declines in their surpluses. Then the appropriate fiscal, monetary, exchange rate and trade policies need to be coordinated toward that goal. The principal U.S. commitment would be to maintain Gramm-Rudman targets to eliminate the federal budget deficit.

If such a strategy is not implemented, the softening U.S. economy could easily spiral downward. Protectionist pressures would build. Pump-priming fiscal measures would undermine deficit reduction. A deepening recession at home would be transmitted abroad as the U.S. export market dwindles.

Trade adjustment will take place in any event. The question is whether it will be through a jointly agreed, export-oriented strategy among major trading nations or through a disruptive international recession. This is the bottom line for so-called international economic policy coordination.

*Ernest F. Preeg is a fellow in international business at the Center for Strategic and International Studies, Washington, D.C.*

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"I realize this is great for tax purposes but frankly I wouldn't be upset if we made a little profit."

## PREPARED STATEMENT OF DONALD M. SPERO

Mr. Chairman and Members of the Committee,

I welcome this opportunity to appear before the Finance Committee as you address various aspects of the ongoing Structural Impediments Initiative. My remarks will focus on the inadequacy of protection for intellectual property rights in Japan—a topic currently and bite properly included in SII's agenda as a specific exclusionary business practice.

Fusion Systems Corporation is a successful exporter to markets all over the world, including Japan. With $33 million in sales, we export a third of our advanced technology products worldwide, with half of these exports going to Japan. We have been successful in the Japanese market, holding dominant market share against strong Japanese competitors in most of our specialized market niches.

In 1986 we opened a wholly owned subsidiary, Fusion Japan, in Tokyo, staffed by six Japanese nationals. We hope to double that number next year. We thus have valued customers, key vendors and outstanding employees in Japan. We have made this major commitment to Japan in part because the combination of demanding customers and tough competitors provides a healthy discipline that helps Fusion to maintain its high quality and leading edge technology.

Yet, in spite of our ability to successfully invent, market and service superior advanced technology products and our willingness to take appropriate risks in the world market, a powerful Japanese competitor can manipulate the Japanese patent system to pose a serious threat to our business. Our competitor claims to have done nothing wrong and MITI appears to agree, dismissing our difficulties as a mere "commercial dispute."

Fusion entered the Japanese market in 1975, filing for patents on our core technology. In 1977, Mitsubishi Electric Company purchased and reverse engineered one of our products, a high power ultraviolet lamp system used to manufacture optical fibers, automotive components, semiconductor chips and many other products. A few months later, Mitsubishi began to file a flood of patent applications in the field of high intensity microwave-driven lamps—the technology pioneered and patented by Fusion in the early 1970's.

To date, Mitsubishi has filed nearly 300 patent applications in Japan, copying and surrounding our technology. Some seek to patent designs in the lamp system they purchased from us. Others represent attempts to secure patents on information clearly in the public domain. Still others claim so-called "improvements" on Fusion's technology that more accurately represent trivial modifications. One Mitsubishi application includes virtually an exact functional copy of a circuit diagram from a Fusion manual. Another seeks to patent a simple clamp attaching two basic components of our lamp system. Yet another seeks to patent the delay between two successive steps in powering up the equipment.

It is as though we invented the car and our competitor then sought a patent on the wheel—an essential component clearly in the public domain. If they "own" the wheel, can we manufacture and sell the car? Their strategy is to use the threat of their "wheel patents" to coerce us into licensing them our basic "car" technology, or to charge us a royalty on each "car" we sell in Japan.

These tactics have not been attempted by Mitsubishi in the U.S. or Europe, where we also hold patents and dominant niche market shares. But their excesses are so blatant in Japan that, if these patents are awarded, Mitsubishi is likely to claim we can no longer make even the lamp they bought in 1977 without violating "their" Japanese patents. Indeed, they have already demanded "royalties" on sales of these lamps, as well as our other products—in effect, a tax on our business in Japan.

In the United States, a similar pattern of behavior would constitute patent fraud and we would have clear and available remedies. Not so in Japan. Indeed, the Japanese patent system not only permits but by its nature invites this behavior on the part of corporations large and powerful enough to afford it. Although a bilateral U.S.-Japan Working Group on Intellectual Property has been established, Japanese negotiators have so far shown little inclination to significantly alter their patent system to curtail activities of this kind.

Clearly, Fusion has collided directly with a massive structural barrier in the form of the Japanese patent system. Most Americans with experience in Japan readily acknowledge this problem, and increasingly, though cautiously, U.S. companies are beginning to discuss the issue publicly.

These cases dramatically illustrate the need for pro-active government focus at the highest level to correct aspects of the Japanese patent system which, in the words of former U.S. Patent Commissioner Donald J. Quigg, "act as a formidable trade barrier to foreign business."

Senator Rockefeller's Commerce subcommittee has compiled a comprehensive list of problems experienced by U.S. companies trying to protect technological knowhow under the Japanese system. The Fusion case is one of many examples that demonstrate how the Japanese patent system is short on both *disincentives* for piracy and adequate *remedies* for those who find their technologies targeted by predators.

I will cite just a few examples: The average period of patent pendency in Japan is about six years, but patent applications are made public after 15 months. Competitors thus enjoy more than four years to use innovations disclosed in these applications to build market share without bearing the large entry level R&D costs. The true innovator has no remedies until his patent is awarded. By then, market share is irretrievably lost and, frequently, the technology itself is obsolete.

Having identified a promising technology in the marketplace or through open patent records, companies can then file for patents on essentially trivial differences from the existing patents or products. Without a broad scope of patent claims, or doctrine of equivalents, patents in Japan are routinely awarded on claims showing only very minor differences from existing technology.

Prior art—that is, previously existing technology—is supposed to be disclosed under the Japanese system. Routinely, it is not, so the applicant need not explain why his claimed invention is truly innovative. Mitsubishi, for example, did not tell the Japanese patent office that it had purchased a Fusion product before filing its first patents on high intensity microwave lamps. Yet, the Japanese patent fraud statute has never been enforced. Predatory companies thus feel free to target promising technologies and to file for patents derived from the products of others.

A majority of the most valuable American innovation comes from small businesses which often can afford neither the time nor the expense of pursuing the slow, costly and uncertain remedies offered by the Japanese patent and judicial systems. Consequently, targeted innovators cross license their core technology to pirating competitors to assure themselves at least a small share of the market. So common is this practice that former Commissioner Quigg has said of the Japanese patent system, "they indirectly have a massive mandatory licensing system."

Regis Mcffenna, an adviser to Apple Computer, estimates that between 1950 and 1978 Japan paid only $9 billion for 32,000 technology licenses from predominantly small companies—inventions that cost the U.S. as much as $1 trillion to develop. Once the licenses are granted, U.S. innovators, whether large or small, typically cannot succeed in Japan against Japanese competitors making the same products.

The costs of this loss of our intellectual property base are enormous. Most structural barriers to trade result in a current loss of sales with a resulting unfavorable effect on the current trade balance. With loss of intellectual property, however, we lose not only *today's* market but suffer an *amplification* of loss into the future. What appears to be lost is just the tip of a technological iceberg; what follows is the iceberg itself—the future and often dramatic expansion of today's new technology into tomorrow's global industry. The jet engine, the transistor, and optical fiber are but a few dramatic illustrations.

The FSX debate focused Congressional attention on the difficult matter of involuntary technology transfer (coincidentally, to Mitsubishi) and its potentially enormous impact on U.S. competitiveness in the future. The Fusion-Mitsubishi dispute similarly raises fundamental matters of public policy—involuntary transfer of the vast array of promising advanced technologies that by most accounts form the true long term foundation of our economic strength.

In the wake of the FSX debate, the Senate recently passed Senator Heinz' amendment urging the Department of Defense to consider whether those with whom it contracts are simultaneously pirating technology from U.S. companies. Senator Rockefeller has proposed legislation to strengthen Section 337 for cases involving theft of intellectual property.

Inclusion of the intellectual property rights issue in the SII talks reflects the growing commitment of the Administration, as well, to helping U.S. companies protect what is for many the core of their ability to compete: the uniqueness of their technology.

Spurred in part by the new Trade Act, the Office of the U.S. Trade Representative, the Departments of Commerce and State, and the Patent and Trademark Office have demonstrated active leadership for securing effective protection of U.S. intellectual property in Japan.

American business can certainly improve the way in which we approach protection of our technologies in Japan. With greater CEO involvement and strategic oversight, more careful selection of patent experts abroad and greater knowledge of the pitfalls of the Japanese system, some problems can be avoided. But these steps can not adequately address the underlying structural barriers being discussed here today and in various bilateral and multilateral negotiations.

These barriers are real and significant and constitute a critical element of Japan's tactics for maintaining and enlarging its past successes. The Japanese have developed a winning strategy and will not change it on their own. A survey of 1500 Japanese businessmen conducted by the American Electronics Association in Japan indicated that 68% of those polled felt that Japan would change its policies only as a result of foreign pressure. More specifically, Waseda University professor and patent expert Teruo Doi told an American Chamber of Commerce in Japan group a few weeks ago that any future change in Japan's obsolete patent system will depend on foreign pressure, as it has in the past.

The challenge for U.S. policy is to develop constructive but powerful incentives for such changes in Japan. Some already exist. Clearly Japan stands to gain in the long run by moving closer to the mainstream of intellectual property standards as viewed by the world's major industrialized countries.

Equally clear, Japan will benefit from the growth of innovation and entrepreneurship that it will experience if small Japanese leading edge technology companies are allowed to create and commercialize their own inventions.

The Japanese Government must be persuaded, in the context of SII talks or otherwise, to upgrade their system to the standard of those in the U.S. and Europe where innovators can operate with a reasonable expectation that the fruits of their R&D will not be routinely misappropriated with impunity—and where, with skill and hard work, they can reap the rewards they deserve and continue to reinvest in the technologies of the future.

Attachment.

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The Honorable William V. Roth, Jr.
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United States Senate
Washington, D.C. 20510

Dear Senator Roth,

I have received your questions concerning our experience with the Japanese patent system and am pleased to provide my responses for the Finance Committee hearing record on the Structural Impediments Initiative.

As you are aware, I am not a patent attorney but rather the chief executive of a company successfully doing business worldwide with advanced technology products. My responses necessarily reflect that perspective and experience. The uniqueness and superiority of our products are the basis of our success both here and abroad and, therefore, our ability to protect the proprietary nature of our products is fundamental to our business.

Your questions and my responses follow:

**I. Does the United States have a different patent standard than the rest of the world?**

Patent standards vary from country to country, with Germany, for example, holding to an very high standard of patentability and inventorship and Japan holding to an extremely low standard of patentability and inventorship. In our experience, the United States falls in between but closer to the German patent standard.

In the United States, an inventor must first disclose all relevant prior art of which he is aware and demonstrate that the "invention" claimed is not obvious when compared with the prior art. As a practical matter, an applicant in Japan need not volunteer prior art. Mitsubishi, for example, did not disclose to the Japanese Patent Office (JPO) that they had purchased and reverse engineered a Fusion lamp in 1977, immediately prior to filing their first patent application on high power microwave lamps.

In practice, the patents granted by the JPO are much narrower in scope of protection than U.S. patents. For example, the JPO may insist that an applicant limit his claimed invention to an exact percentage of a particular ingredient and then permit another applicant to obtain a patent on virtually the same formulation with only a miniscule and functionally irrelevant change in the percentage of the ingredient. This narrow scope of protection contributes significantly to the practice of surrounding true innovators with predatory patent filings.

The U.S. has only one type of patent for machines and devices, but Japan also permits "utility models," patents that protect minor improvements in the structure of a device or machine. Utility models were introduced when Japan was industrially weak to assure that even the minor inventions of Japan's fledgling companies could be protected--a justification that clearly no longer exists. The utility model system is an important cause of the delay in issuing patents since it almost doubles the workload and recordkeeping of the Japanese Patent Office.

**2. What is the difference between the "first to file" and "first to invent" standard of granting patents?**

First to file patent systems reward the race to the patent office by granting patents to those who file applications on particular inventions before anyone else. In first to invent systems, the earliest inventor is rewarded with a patent whether or not a competitor has beaten him to the patent office steps.

Apparently for administrative convenience, virtually all patent systems have adopted first to file systems. Indeed, the U.S. system retains virtually the last remaining first to invent system. As a result, innovators with global businesses, such as Fusion Systems, have learned to accomodate to these first to file systems in a number of countries.

In Japan, the first to file nature of the patent system contributes to the aggressive filing practices of many Japanese companies. However, it is the combination of this aspect of the system with other peculiarities of the Japanese system -- low standard of patentability, virtually assured issuance of patents on any applications not opposed by competitors, lack of punishment for patent fraud for failing to disclose known prior art, etc. -- that encourages patent flooding and other predatory practices in Japan more than in other first to file countries.

**3. Do U.S. firms receive "national treatment" in Japan in the area of patent law? In other words, are U.S. firms treated differently than Japanese firms under Japanese law?**

In some respects, U.S. firms are subject to harsher rules under the Japanese patent system than those applied to Japanese firms. Unlike the U.S. Patent and Trademark Office (PTO), for example, the JPO will not accept an application in a foreign language nor will they allow translation errors to be corrected. In the event of a dispute, the Japanese translation governs, even if it contains translation errors. Clearly, U.S. firms relying on translation of their English patents into Japanese will suffer a disadvantage under this system over Japanese firms filing patents directly in Japanese.

Further, U.S. firms usually file in Japan under a treaty requiring a certified priority document to be submitted to the JPO. The unextendable deadline for filing this certification frequently causes U.S. firms to lose patent rights in Japan but is of no concern to Japanese firms which need not file this certification at all.

In yet another example, U.S. firms are required to hire Japanese patent attorneys to handle their applications in Japan. Japanese companies are not required to use patent attorneys and frequently do not. JPO permits Japanese attorneys to maintain a fixed fee schedule requiring foreign firms to pay much more for filing an application than Japanese companies. Thus, even excluding translation costs, American companies typically pay more to file patents in Japan than Japanese companies.

Even more damaging, perhaps, is the treatment of foreign firms under Japanese practice rather than law. Much predatory patenting is undertaken with the ultimate goal of extracting a cross license to valuable core technology -- just as Mitsubishi sought a royalty free worldwide cross license from Fusion Systems after surrounding our microwave lamp technology with a flood of unworthy patent applications.

Typically, smaller Japanese firms agree to these cross licensing arrangements because that is "the Japanese way." These acquiescent firms are usually rewarded with an assigned rung on the ladder -- some pre-determined portion of the market. In the case of a U.S. firm, however, that assigned place is likely to be off the ladder entirely. The practical result of such a cross license is that, when a Japanese firm can make the identical product under a license agreement, the "buy Japanese" mentality will insure that little or nothing will be purchased from the U.S. innovator.

In sum, the Japanese patent system is far more costly and opaque to U.S. firms than to Japanese companies. Not surprisingly, U.S. companies obtain only about 4% of the patents and utility models issued in Japan, while Japanese companies obtain 20% of patents issued in the U.S.

Respectfully submitted,

Donald M. Spero
President

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March 15, 1989

Senator Jay Rockefeller, Chairman
Commerce, Science & Transportation Subcommittee
  on Foreign Commerce & Tourism
Committee on Finance
United States Senate
Washington, D.C.

Re: Hearings on Japanese Patent System

Dear Senator Rockefeller:

I am patent counsel for Fusion Systems Corporation, and am writing to offer my views and comments on the Japanese patent system. I ask that these be considered by your Committee, and that they become part of the permanent record of these hearings.

To begin with, the Fusion "story" bears repeating, since it so clearly illustrates how the Japanese patent system as presently structured, can result in fundamental unfairness to American companies who are trying to protect their technology in order to better compete in Japan.

Fusion Systems is a small high technology company which is located in Rockville, Maryland. In the early 1970's, they pioneered the development of a new product which later became known as an "electrodeless lamp", and during the decade of the 1970's they were the only producer of such lamps in the world. However, in 1977, a large Japanese company purchased the Fusion lamp, "reverse-engineered" it, and proceeded to file patent applications in Japan directed to various features of the Fusion lamp they had purchased, as well as a large number of additional patent applications. This same company then entered the market with its own version of the electrodeless lamp, and when the patent issue was raised, demanded a cross-license under Fusion's basic patents in return for a license under their patents including those which had been copied from the Fusion product.

While in the United States this would be considered to be unethical and illegal, apparently in Japan it is acceptable procedure. The reason for this is the lack of any meaningful "patent fraud" laws in Japan. This means that it is not considered to be wrong to file for patents on inventions which the patent applicant knows he did not really invent. Further, it means that the patent applicant is not obligated to advise the Patent Office of relevant prior art of which he knows. This may result in the incomplete examination of patent applications, since frequently the patent applicant, who is working in the specific technology involved, is aware of the best prior art, which may not be available to the patent examiner. For example, in the Fusion case, the patent examiner had no way of being familiar with the features of the Fusion lamp which had been purchased by the patent applicant who then filed for patents on exactly such features. By way of background, both the prohibition against filing patent claims on inventions which were not invented by the applicant and the duty for the applicant to cite the most relevant prior art of which he is aware, have been basic tenets of U.S. patent law for many years.

In Japan there is an opposition system, through which any interested party may oppose the grant of a patent. However, the opportunity for opposition is not a cure for the omission of basic patent fraud standards. Thus, besides being expensive, opposition proceedings put the burden of "undoing" something on the opposer, which perhaps never should have been done in the first place, as many oppositions would no doubt be unnecessary if the patent applicant had a duty of candor, and either did not submit claims which it knew to be invented by another or advised the Patent Office of the most relevant prior art to enable a full examination. Finally, since there is no provision for discovery in either oppositions or in patent litigation in Japan, the patentee can continue to hide the best prior art, even while suing another company for patent infringement.

It is fair to ask the question:

> "What is the result of a patent system which allows the filing of patents on inventions which have been made by others, puts the burden of defeating such patents on the true inventor, and does not allow the true inventor to discover key aspects of his case?"

The clear result is a system which encourages the sharing of intellectual property rights rather than their exclusive ownership. Many companies would rather agree to cross-license their basic technology than contend with the many obstacles incident to obtaining and maintaining an exclusive patent position. Indeed, the Japanese patent system allows the business strategy of one company securing a position in the basic technology of another by filing for "improvement" patents and then demanding a cross-license.

This practice finds support in the letter as well as the spirit of Japanese law. Thus, under Article 92 of the Japanese Patent Law, the patentee of an improvement invention can petition the Government for a compulsory license under a basic patent which is owned by another party and which would be infringed by practicing the improvement.

By way of example, this might mean that if party A invents the wheel, and party B is successful in getting a patent on a wheel with red spokes, then party B can force a compulsory license under the basic wheel patent.

Of course, the thinking which underlies this type of law is at odds with the basic concept of a patent as being an "exclusive" right. Further, it is most detrimental to American companies who are frequently in the position of being the innovators of the basic technology.

In summary then, the undersigned is of the sincere belief that the United States should encourage that the patent laws of Japan be changed in the following ways:

1) to make it unethical and illegal for an attorney or patent applicant to file patent claims which he knows were invented by another party and thus are anticipated;

2) to require that all patent applicants have a duty to disclose relevant prior art of which they are aware to the Patent Office;

3) to provide for discovery in patent litigation; and

4) to repeal Articles 92 of the Japanese Patent Law relating to compulsory licenses.

I especially feel that items 1 and 2 are essential to provide a patent system which is fundamentally fair and which results in the issuance of meaningful patents.

I am aware that in the United States, the enforcement of the patent fraud laws has perhaps been too severe in recent years, and no doubt some practitioners and companies have been unjustly accused. As a consequence, there may be some perception, especially on the part of those who feel most vulnerable, that the patent fraud concept should not be extended to Japan.

However, the fact that there have been some excesses in this country does not justify the total absence of patent fraud provisions in Japan, since it is my opinion that such provisions are essential to the operation of a patent system which is to be fair and meaningful. In this view I feel confident that I would be joined by many other members of the patent bar.

I therefore respectfully request that the Committee carefully consider the foregoing comments. If additional information should be desired, kindly contact the undersigned.

Sincerely,

Martin Abramson

Martin Abramson

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November 21, 1989

The Honorable Max Baucus, Chairman
Subcommittee on International Trade
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Senator Baucus,

On November 7, 1989, Dr. Robert Rines testified at your hearings on the Structural Impediments Initiative as to the nature of the Japanese patent system. Dr. Rines testified that there was no significant difference in the period of pendency between the U.S. and Japanese patent systems and that, in his 40 years of practice, he had perceived no significant difference in operating within the U.S. and Japanese patent systems. He offered, in fact, to provide extensive client files supporting his claim.

Among Dr. Rines' clients is a small U.S. company which Fusion Systems acquired and operated for a period of time. Although Dr. Rines has never represented Fusion Systems Corporation, he did serve as patent counsel to the acquired company during the period of our ownership. We therefore can speak to the experience of at least one of those clients.

Our documentation clearly demonstrates that, contrary to Dr. Rines' testimony, the experience of this client shows the typical pattern of long delays in obtaining Japanese patents--periods of pendency significantly in excess of those experienced in the United States.

A listing of patent applications filed in the U.S. and Japan and the periods of pendency follows:

| Country | Date Filed | Date Issued | Time Elapsed |
|---|---|---|---|
| USA | 4/24/78 | 8/27/85 | 7 years and 4 months |
| Japan | 4/12/79 | Not yet issued | (pending over 10 years) |
| USA | 10/5/78 | 2/24/81 | 2 years and 4 months |
| Japan | 2/23/79 | Not yet issued | (pending over 10 years) |
| USA | 8/18/70 | 3/13/73 | 2 years and 7 months |
| Japan | 8/16/71 | 1/18/78 | 6 years and 5 months |
| USA | 3/24/72 | 12/73 | 1 year and 9 months |
| Japan | 3/19/73 | 5/8/78 | 5 years and 2 months |
| USA | 6/16/71 | 11/7/72 | 1 year and 5 months |
| Japan | 5/18/72 | 2/26/82 | 9 years and 9 months |
| USA | 9/6/78 | 1/20/81 | 2 years and 4 months |
| Japan | 12/9/75 | 10/29/86 | 10 years and 10 months |
| USA | 1/13/77 | 7/8/80 | 3 years and 6 months |
| Japan | 12/27/79 | Not yet issued | (pending 10 years) |
| USA | 6/21/76 | 7/11/78 | 2 years and 1 month |
| Japan | 5/8/75 | 9/19/83 | 7 tears and 4 months |
| USA | 6/20/73 | 9/3/74 | 1 year and 3 months |
| Japan | 5/16/72 | 3/31/82 | 9 years and 1 month |
| USA | 2/17/77 | 7/11/78 | 1 year and 5 months |
| Japan | 5/22/78 | Not yet issued | (pending over 11 years) |
| USA | 10/4/82 | 12/25/84 | 2 years and 2 months |
| Japan | 6/1/83 | Not yet issued | (Exam not requested) |
| USA | 4/22/83 | 6/4/85 | 2 years and 2 months |
| Japan | 4/20/84 | Not yet issued | (Exam not requested) |
| USA | 2/25/85 | 5/27/86 | 1 year and 3 months |
| Japan | 2/25/86 | Not yet issued | (Exam not requested) |
| USA | 3/29/85 | 3/24/87 | 2 years |
| Japan | 3/26/86 | Not yet issued | (Exam not requested) |

A similar evaluation of Dr. Rines' trademark filings for our former subsidiary shows a similar pattern, with U.S. trademark protection consistently issued in a shorter time than similar protection in Japan.

It is important, too, to note that Dr. Rines did not address himself to such overriding concerns as excessively narrow scope of claims and other incentives in the Japanese system to patent flooding and other predatory practices. When asked about these matters informally after the hearing, Dr. Rines said simply that such problems may exist but he was not asked about them during the course of the hearing. Therefore his testimony should be read in a very limited way, addressing as it does almost exclusively the matter of delay, an area where a body of contrary evidence already exists.

Dr. Rines testified that "people who are whining or complaining about (the Japanese patent system) have some bone to pick in Japan because they are not able to do something else in Japan." On the contrary, we at Fusion are market leaders in Japan, having successfully attracted Japanese customers with high quality, advanced technology products. It would be folly, however, for successful innovators to ignore characteristics of the patent system that invite predatory competitors to use that system as a lever to extract our most promising technologies.

Some may take Dr. Rines' testimony to represent an accurate statement of the situation faced by U.S. businesses seeking effective patent protection in Japan. It would be tragic and costly, however, if Congress chose to craft its policies based on the opinions of those who fail to see the problems rather than those who not only recognize but are struggling to deal with them. Senator Rockefeller's Commerce subcommittee has made considerable strides in documenting the extraordinary difficulties faced by U.S. businesses seeking intellectual property protection in Japan. I would urge the Finance Committee to lend its expertise and its forum to further exploration of these complex and pressing issues.

I commend your initiative in holding the November SII hearings and was pleased to participate. I respectfully request that this letter be included in the hearing record.

Sincerely,

Donald M. Spero

Donald M. Spero
President

# COMMUNICATIONS

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## STATEMENT OF THE AMERICAN CHAMBER OF COMMERCE IN JAPAN

Prompt and comprehensive protection of Intellectual property rights by Japanese patents, trademarks and copyright, Is one of the foundations of any company's business operations in Japan. In recent years the Japan Patent Office (JPO) has made progress in reducing the uncommonly long time required for the processing of patent and trademark applications. The ACCJ also applauds the JPO's efforts to promote the harmonization of intellectual property protection in cooperation with the U.S. Patent and Trademark Office and the European Patent Office. Its constructive attitude is also reflected in the decision, notified to the U.S. Government in April 1989. to introduce service mark protection within the next three to four years a move long sought by Japan's trading partners. The ACCJ, in conjunction with the Japanese Government, continues to support the copyright protection of software.

### POSITION

The JPO has shown a receptive attitude toward discussing and dealing with reported problems. However, there remain difficulties that Interfere with established commercial relationships of American firms in Japan, or obstruct entry into the Japanese market. The following are of particular concern to the ACCJ.

1. Average patent pendency—the period between filing of application and issue of patent in Japan is one of the longest among developed countries. Coupled with the practices of laying open all applications to public inspection 18 months after filing, this can result in a long period of public access to the application without legal protection of the invention claimed.

2. The filing of large numbers of applications to cover slight variations in known technology, facilitated by access to previously laid-open applications, is widely practiced by Japanese companies. Such "patent flooding" works against the JPO's efforts to shorten patent pendency. Moreover, Interpretation of Patent claims by the courts tends to be extremely narrow. This aggravates the problem of patent flooding and reduces the protection afforded by a patent.

3. There is no discovery procedure whereby the owner of a process patent may seek evidence of suspected infringement.

4. After examination, but before a patent is granted, a successful application is published and may be opposed by third parties who offer reasons why the invention may not be patentable. This often attracts similar or virtually identical oppositions from numerous challengers. The applicant cannot prepare a general response, but must defend against each opposition separately. Collusive oppositions can cause substantial delay in the grant of a patent, thus further prolonging the period of public access to the information without legal protection of the invention.

5. Japanese law does not provide adequate protection of trade secrets—a problem that grows with the increasing willingness of mid-career technical and managerial personnel to change companies.

6. The JPO accepts patent applications in Japanese only, whereas the U.S. Patent and Trademark Office accepts initial filing In languages other than English, followed by a translation within a specified period. For priority status American applications to the JPO must be filed within a year after U.S. filing scant time for a careful translation into Japanese in addition to revising the text to meet Japanese criteria.

7. The JPO has long permitted firms in service industries to register trademarks for products used in conjunction with their services. Rejections of such marks are now being reported, however, and there is concern that existing registrations will not be granted renewal.

### ACTION

The ACCJ urges the Government of Japan to take administrative or legislative action for the following purposes:

1. To keep patent applications confidential prior to publication for opposition, until average patent pendency becomes comparable to that in other developed countries.
2. To broaden the interpretation of patent claims sufficiently to protect minor modifications, thus removing any need for redundant applications.
3. To provide administrative means by which a patent owner can obtain information about processes suspected of infringement, with appropriate safeguards against frivolous use of those means.
4. To consolidate multiple oppositions into a single opposition, to which the applicant may provide a single response.
5. To establish and define trade secrets as a form of property and to provide means for their protection.
6. To permit initial filing of patent applications in languages other than Japanese, followed by a provision of a translation into Japanese within a reasonable period.
7. To resume the JPO's practice of registering and renewing the marks of service industry firms in trademark classes appropriate to products used in their business, and to expedite the promised establishment of a registration system for service marks, thus providing full protection of these properties.

# STATEMENT OF THE CHOCOLATE MANUFACTURERS ASSOCIATION AND THE NATIONAL CONFECTIONERS ASSOCIATION TO THE INTERNATIONAL TRADE SUBCOMMITTEE OF THE SENATE FINANCE COMMITTEE

## Regarding Agriculture Trade and the General Agreements on Tariffs and Trade

We appreciate the opportunity to submit written comments to the Subcommittee. Since only agriculture producers were invited to testify orally, we hope the Subcommittee understands the importance of the agriculture section of the trade negotiations to consumers of agriculture products.

Comments are in two sections. The first addresses domestic sugar, peanut, and dairy price support programs which the industry views as serious trade distorting practices that should be eliminated in the Uruguay Round. The second is directed to reductions in the present U.S. confectionery tariff rates.

### Summary

The U.S. confectionery industry's objectives in the Uruguay Round include eventual worldwide duty free trade in confectionery. Accordingly, we are prepared to table phasing out U.S. import duties of 5% and 7% simultaneously with the elimination of U.S. and foreign sugar, dairy and peanut trade-distorting programs and commensurate reductions in foreign confectionery tariffs.

The industry is not prepared to accept U.S. confectionery duty rates below 5% and 7% prior to a multilateral resolution of the agricultural support issue and reciprocal tariff reductions.

We believe that it is vital for the United States to begin phasing out its agricultural import quotas and changing its own domestic price support programs in 1990 if the Administration expects to successfully negotiate improved international rules on agricultural trade. The U.S. support programs for sugar, peanuts, and dairy are trade-distorting practices which are:

> Barriers to the industry's free international access to lowest cost raw materials;
>
> Cost burdens and administrative burdens handicapping the competitiveness of U.S. semi-manufactured and finished chocolate and non-chocolate confectionery in the domestic and international market; and,
>
> An obstacle to negotiating the elimination of tariff and non-tariff barriers to U.S. confectionery in principal international markets.

It is understood that the full schedule of products of concern to the industry will be divided and negotiated separately in the Uruguay Round. Sugar, dairy, peanuts and unprocessed and semi-manufactured cocoa and chocolate raw materials affected by U.S. price support programs will come under the Negotiating Group on Agriculture. Finished non-chocolate and chocolate confectionery will be negotiated in the market access negotiations on a request-offer basis.

Attachment A is a comprehensive list of cocoa and chocolate products of concern to the industry with HS and TSUS numbers, tariff rates, and indications where quotas are applied.

## I. U.S. Non-Tariff Barriers - Agricultural Quotas & Support Programs

Peanuts, dairy and sugar are the basic ingredients for confectionery. United States confectionery companies use 1.5 billion pounds of sugar, 400 million pounds of peanuts and well over 200 million pounds of dairy products in confectionery. All of these major ingredients are covered by import quotas and domestic programs that significantly increase the cost to the U.S. manufacturer. Quotas on sugar-containing products, dairy products and peanuts are maintained under Section 22 of the Agricultural Adjustment Act of 1933, as amended ("Section 22 quotas"). Section 22 permits the President to restrict imports whenever they threaten to interfere materially with domestic price support programs. Unlike Section 22, GATT rules require agricultural import quotas to be accompanied by production or marketing controls. Most Section 22 quotas, therefore, would be illegal under the GATT but for a broad waiver the United States obtained from its trading partners in 1955 specifically to permit action under Section 22.

The sugar import quota is maintained under so-called Tariff Headnote authority. In June 1989, a GATT panel decided that this quota was not sanctioned by any international trade rule. The United States has yet to indicate the substantive changes it intends to make to the sugar program.

We believe that it is vital for the United States to begin phasing out its agricultural import quotas and changing its own domestic price support programs in 1990 if the Administration expects to successfully negotiate improved international rules on agricultural trade. The U.S. support programs for sugar, peanuts, and dairy are trade-distorting practices which are:

Barriers to the industry's free international access to lowest cost raw materials;

Cost burdens and administrative burdens handicapping the competitiveness of U.S. semi-manufactured and finished chocolate and non-chocolate confectionery in the domestic and international market; and,

An obstacle to negotiating the elimination of tariff and non-tariff barriers to U.S. confectionery in principal international markets.

High cost for domestic ingredients result in a more expensive finished product. Because of very low U.S. confectionery tariffs, the industry faces heavy competition in the U.S. market from foreign manufacturers who have access to cheaper raw materials.

In the international market, the higher cost U.S. confectionery export faces foreign tariffs ranging from 10% to 80% assessed on the CIF value. The higher the "upfront" cost to bring American confectionery into a foreign market, the harder it is to price competitively against strong local manufacturers, and fund necessary advertising and promotion activities.

In order to maintain quality and cost efficiency in both the domestic and international market the industry must have access to lowest cost raw materials. Therefore the industry strongly supports the Administration's objective of phasing out trade distorting subsidies on sugar, dairy and peanuts and establishing a market oriented agricultural trading system.

The relevant U.S. tariff item numbers for these products are:

| | |
|---|---|
| 1701.11 | Cane Sugar |
| 1701.12 | Beet Sugar |
| 0402.10 | Dry Milk |
| 1202.10 | Peanuts in Shell |
| 1202.20 | Peanuts Shelled |

## Sugar

Import duties are negligible at about six tenths of a cent per pound. Most exporting countries that supply the U.S. are exempt from duties under the Generalized System of Preferences or the Caribbean Basin Economic Recovery Act. Eliminating the remaining duty would have no substantive effect on U.S. consumers or producers. Similarly, the one-cent per pound import fee on refined sugar is an inconsequential part of the protective structure.

The U.S. sugar program is enforced by restrictive quotas on sugar and a broad range of sugar containing products. Quotas assure the maintenance of an internal sugar price significantly higher than world prices. For example, in the first half of 1989 the average world price of raw sugar was approximately 12 cents and 18 cents for refined. The U.S. sugar program supported the market price of raw sugar at approximately 22 cents per pound. Normally this results in a wholesale fob refined sugar price of about 25 cents for beet sugar and 26 cents for cane sugar.

The elimination of the U.S. sugar program would be a major benefit to consumers. It is estimated that a six-cent reduction in the raw sugar loan rate (from 18 cents to 12 cents) would reduce the market price by an equivalent amount, i.e. to 16 cents per pound. This would result in an average refined sugar price of approximately 20 cents per pound at the wholesale level.

A 1988 study by the U.S. Department of Commerce demonstrated that changes in the price of sugar are passed on to consumers by food processors (as are changes in the prices of other commodity inputs such as flour, oil and dairy products). After taking into account retail markups and the price protection provided for corn and other alternative sweeteners, a one-cent reduction in raw sugar prices lowers the wholesale cost of all sweeteners by about $300 million. Thus, a six cent per pound reduction would represent a savings to consumers of about $1.8 billion.

The June 1989 GATT panel decision all but mandates the U.S. Government to either eliminate or substantially increase the sugar import quota as soon as possible - regardless of the outcome of the Uruguay Round talks. The credibility of the United States as a leader in world trade system reform will be severely undermined if that decision is ignored or diluted.

## Peanuts

The United States' peanut price support program is one of the most egregious examples of agricultural protectionism in this country. A comprehensive explanation of the operation of the program and its effect on the domestic and international market is appended to this statement (Attachment B). The following paragraphs highlight the reasons it should be tabled in the Uruguay Round and a multilateral agreement reached to begin phasing it out in 1990.

The basic elements of support for U.S. peanut prices and farmer income are government loans; strict limits on domestic supply by means of poundage quota; and the Section 22 quota which virtually bans imports.

The Food Security Act of 1985 authorizes the Secretary of Agriculture to establish annually a national poundage quota limiting the amount of peanuts that may be grown for domestic supply and put upward pressure on the price. The Section 22 quota on imported peanuts insures the limited supply by allowing a mere 900 short tons of peanuts to be imported annually -- less than 0.1% of total U.S. consumption.

## Inflated Domestic Price

Production and import quotas create an artificial shortage in the domestic supply of peanuts. The artificial shortage combined with the USDA's current loan level of $617 per short ton, drives up manufacturers cost to purchase "quota peanuts" (grown for domestic edible use) to about $650 per short ton or almost double the world price. The average world price in 1989 for equivalent peanuts was $332 per short ton.

Each year the U.S. support price for quota peanuts far exceeds production costs. In 1988, the support price was 50% above production costs as calculated by USDA. However, because USDA has consistently set the internal quota at far below actual domestic demand, consumer industries have had to pay an additional 10% premium over the already inflated support price to purchase peanuts from the Commodity Credit Corporation (CCC) or to entice the growers to deliver peanuts to the commercial market rather than to the CCC.

If the peanut import quota were eliminated, U.S. domestic prices would fall at least to the level of the inflated USDA production cost estimate which is the basis for the support price. A just completed study of the U.S. peanut program (Attachment C) estimated that if U.S. quotas and subsidies were eliminated and a free market was achieved, the price of shelled peanuts would fall by at least 30%. Domestic consumers would save a total of $378 million on 2.35 billion pounds of peanuts.

## Increased peanut exports earnings

Increased export earnings for U.S. growers may be among the most significant effects of eliminating the import quota. The current system discourages production for export because the U.S. grower will produce for the high support price. Any residual production is "dumped" on the world market usually at prices well below production costs. Elimination of the U.S. import quota, and hence the de facto domestic subsidy, could be expected to increase the world price and draw U.S. peanut production into the world market.

Elimination of the U.S. peanut import quota and the U.S. peanut program would have a definite positive impact on the U.S. economy. The price support system used to protect peanut farmers results in inefficient production, inflated prices for the consumer, and minimal export earnings for the United States. Any price support that current peanut farmers might need during the transition from a closed to open market can be provided through tariffs. Tariffs would offer a buffer to the farmers at a minimum expense to U.S. consumers.

## Dairy

In addition to import quotas, the Federal milk price support program and federally sanctioned system of milk marketing orders are the main policy instruments for establishing milk prices. The government maintains the support price by purchasing manufactured products, such as non-fat dry milk, at announced prices that are high enough to keep the price of manufacturing grade milk at the support level. The Federal Milk Marketing Order Program specifies minimum prices for milk sold for fluid use in the marketing orders in the United States.

To maintain the domestic price support level for dairy products, dairy imports into the U.S. are restricted through Section 22 quotas. Under Section 22 quotas, imports of dairy products have been held to negligible levels, about 1.5 - 1.9 percent of U.S. production since 1974.

Dairy quotas compounded by sugar quotas also severely limit access for semi-finished foreign chocolate and cocoa preparations to the U.S. market. These are important raw materials used in the production of confectionery, baked goods, ice cream, and drink mixes.

Most countries support their dairy industries in some way and their domestic dairy prices are on a par with the United States. However, as with sugar and peanuts, the ability to freely access the world market, including the modest one for dairy, is an important cost control mechanism that should be available to U.S. industry.

## II. Tariffs

Semi-manufactured cocoa and chocolate products not already at zero rate of duty are:

| | |
|---|---|
| 1803.20 | Cocoa paste, part or wholly defatted |
| 1805.00 | Cocoa powder unsweetened |
| *1806.1030 | Cocoa powder sweetened |
| *1806.2040 | Chocolate & other food preparations in blocks, slabs, powder, etc., not containing milkfat; or containing butterfat, and milk solids |
| 1806.2060 | Confectioners coatings |
| *1806.2070 | Other |
| *1806.2080 | Other |

Currently there are absolute quotas on many items falling into the astericked categories.

Products of concern to the industry and subject to request offer are the following tariff items:

| | |
|---|---|
| 1806.31 | Chocolate preparations - filled |
| 1806.32 | Chocolate preparations - not filled |
| 1806.90 | Other, Chocolate Confectionery |
| 1704.90 | Sugar Confectionery (Not containing cocoa) |

In the 1979 Tokyo Round, U.S. import duties on finished chocolate and non-chocolate confectionery were immediately cut to 5% and 7% and bound at that rate. Semi-manufactured products such as bulk chocolate were staged down to zero duty effective last year. Reductions to the equivalent level, however, were not obtained from trading partners. U.S. semi-manufactured and finished confectionery exports continue to face tariffs of between 10% and 80% in foreign markets.

The Uruguay Round is an opportunity to redress this inequity and obtain the same opportunities for U.S. confectionery in foreign markets as foreign confectionery manufacturers have in the United States.

The U.S. Trade Representative has been requested to seek a confectionery tariff level of not more than 7% among all developed and newly developed nations effective January, 1991. Less developed countries should immediately adopt confectionery tariffs of not more than 20% with short term staging to 7%.

The U.S. confectionery industry's objectives in the Uruguay Round include eventual worldwide duty free trade in confectionery. Accordingly, we are prepared to table phasing out U.S. import duties of 5% and 7% simultaneously with the elimination of U.S. and foreign sugar, dairy and peanut U.S. market access restrictions and price support programs and commensurate reductions in foreign confectionery tariffs.

The industry is not prepared to accept U.S. confectionery duty rates below 5% and 7% prior to a multilateral resolution of the agricultural subsidies issue and reciprocal tariff reductions. Further, we ask that the U.S. Trade Representative consult with the industry if requests for U.S. confectionery duty reductions are tabled in Geneva.

## Conclusion

The confectionery industry urges the Administration to table U.S. sugar, dairy and peanut import quotas and subsidy programs and seek reductions in agricultural subsidies on a multilateral basis. In combination, U.S. market access restrictions, U.S. support programs and foreign subsidies contribute to higher consumer costs; perpetuate inefficiencies in domestic and international production; and distort world trade in sugar, peanuts, and dairy, and products containing them.

The elimination of trade distorting agricultural quotas and price supports should also enable governments to relinquish those tariff and non-tariff barriers to products containing sugar, dairy and peanuts that were created and maintained solely to protect and compensate domestic consumer industries negatively affected by these subsidy programs.

ATTACHMENT A

## UNITED STATES HARMONIZED TARIFF SCHEDULE
## CHAPTER 18: COCOA AND CHOCOLATE PREPARATIONS

| | Old No. | *New No. | Duty | Quota | Type | Products |
|---|---|---|---|---|---|---|
| **COCOA** | | | | | | |
| Beans | 156.10 | 1801.00 | Free | No | | |
| Shells, husks, waste | 156.50 | 1802.00 | Free | No | | |
| Cocoa Paste | | | | | | |
| Defatted | 156.20 | 1803.10 | Free | No | | |
| Part or wholly defatted | 156.40 | 1803.20 | $.82/kg | No | | |
| Cocoa Butter | 156.35 | 1804.00 | Free | No | | |
| Cocoa Powder Unsweetened | 156.40 | 1805.00 | $.82/kg | No | | |
| Cocoa Powder Sweetened | | | | | | |
| <65% Sugar by weight | 156.45 | 1806.1020 | Free | 9904.6020 | Sugar | |
| Put Up for Retail Sale | 156.45 | 1806.1020.30 | Free | Yes | | |
| Other | 156.45 | 1806.1020.90 | Free | Yes | | |
| >65% sugar but <90% | 183.05 | 1806.1030 | 10% | 9904.6020<br>9904.5040 | Sugar<br>Sugar | Swt cocoa powder |
| Other: | 155.2025 | 1806.1040 | Fees | Yes | Sec. 22 | Swt cocoa powder >90% sugar |
| **BULK CHOCOLATE** | | | | | | |
| Chocolate & other food preparations in blocks, slabs, liquid, paste, powder, granular or other bulk form weighing > 2 kg. | | | | | | |
| Containing not > 32% milk or butterfat & not > 60% sugar - in blocks or slabs 4.5 kg or more | 156.25 | 1806.2020 | Free | 9903.1710 | EEC | 10 lb. blocks |
| Not containing butter or milkfat solids | 156.3045 | 1806.2040.20 | 5% | No | | |

**Bulk Chocolate & preparations in blocks or containers weighing > 2 kg. Con't:**

| | Old No. | New No. | Duty | Quota | Type | Products |
|---|---|---|---|---|---|---|
| Containing over 5.5% butterfat | 156.3050 | 1806.2040.40 | 5% | 9904.1063 | Dairy | Chocolate Crumb |
| Containing not over 5.5% butterfat or containing other milk solids | 156.3065 | 1806.2040.60 | 5% | 9904.1066 | Dairy | Chocolate Crumb |
| Confectioners'coatings and other products except confectionery containing not <6.8% non-fat solids of cocoa bean nib and not <15% other vegetable fats | 157.4700 | 1806.2060.00 | 2.5% | No | | |
| Other: Containing more than 65% sugar | 183.0515 | 1806.2070 | 10% | 9904.5040<br>9904.6060 | Sugar | White Crumb |
| Other: | 183.0030 | 1806.2080 | 10% | Yes | Sugar, dairy, EEC | |
| Put up for retail sale | 183.0030 | 1806.2080.45 | 10% | No | | |
| Other | 183.0030 | 1806.2080.90 | 10% | Yes | | |
| **Blocks, Slabs or Bars (weighing less than 2 kg)** | | 1806.3100 | 7% | 9903.1705<br>9904.5040 | EEC<br>Sugar | Confectionery |
| Filled-For retail sale | 157.1045 | 1806.310045 | 7% | Yes | EEC | |
| Filled-Other | 157.1050 | 1806.310050 | 7% | Yes | EEC | |
| Not Filled: Preparations containing not > 32% butterfat or milk solids and not > 60% sugar | 156.3020 | 1806.3220 | 5% | 9904.1063<br>9904.1066 | Dairy<br>Butterfat | Confectionery |
| Put up for retail sale | 156.3020 | 1806.3220.45 | 5% | No | | |
| Other | 156.3020 | 1806.3220.50 | 5% | Yes | | |

(2)

**Blocks, Slabs, Bars**
**weighing less than 2 Kg Con't:**

|  | Old No. | New No. | Duty | Quota | Type | Products |
|---|---|---|---|---|---|---|
| Other Not Filled: | 157.10 | 1806.3240 | 7% | 9903.1705<br>9904.1075<br>9904.1081 | EEC<br>Dairy<br>Dairy |  |
| Put up for retail sale | 157.1045 | 1806.3240.45 | 7% | No |  |  |
| Other | 157.1050 | 1806.3240.48 | 7% | 9904.1081 | Dairy |  |
| **Other:** |  |  |  |  |  |  |
| Put up for retail sale | 157.1045 | 1806.9000.45 | 7% | No |  |  |
| Other | 157.1050 | 1806.9000.90 | 7% | Sugar, Dairy, EEC |  |  |

* HS Commodity Numbers are used for both import and export

## KEY TO QUOTA REFERENCES

| | |
|---|---|
| 1903.1705 | Non-restrictive quota on confectionery imported from EEC. |
| 1903.1710 | Non-restrictive quota on chocolate in ten pound blocks from EEC. |
| 1904.1063 | 1989 Quota limit of 9,711 mt of chocolate crumb with 5.5% or more butterfat. Allowed only from Ireland, UK, Netherlands, and Australia. |
| 1904.1066 | 1989 quota limit of 2,123 mt of chocolate crumb with less than 5.5% butterfat. Imports allowed only from UK and Ireland. |
| 9904.1075 | Imports prohibited of dried milk, whey, and buttermilk containing less than 5.5% butterfat - alone or mixed with sugar. |
| 9904.1081 | Imports of articles containing more than 5.5% butterfat but less than 45% prohibited except for small quantity from Australia, Belgium & Denmark. |
| 9904.5020 | Imports prohibited of blended sugar syrups i.e. chocolate syrup capable of further processing. |
| 9904.5040 | Imports prohibited of articles containing over 65% sugar and capable of further processing. |
| 9904.6020 | 1989 quota limit of 2,721 mt on articles containing over 10% sugar in dry, amorphous form, ie. sweetened cocoa, not for retail sale. |
| 9904.6060 | 1989 quota of 76,203 mt on articles containing 20% or less of sugars and intended for further processing. |

## Attachment B

### Peanuts

Elimination of the U.S. Section 22 peanut import quota, while technically a U.S.-trade "concession," in fact would positively affect the U.S. peanut industry and peanut consumers (including our members) in at least three ways: domestic peanut production would increase; U.S. consumers would save as much as $375 million; and finally, U.S. export earnings from peanuts would increase by as much as $68 million. In our economic analysis (see attachment C), we have assumed that if no import restrictions applied and domestic peanut price for edible peanuts were unregulated, domestic prices would fall nearly to the level of long-term U.S. production costs. We have assumed also that no trade barriers other than current tariffs would exist following elimination of the quota. It is important to note, however, that even if tariffs were to rise above current levels, by eliminating import quotas, our members would be better off, so long as tariffs were ultimately phased out.

#### 1. Background

Under current law, the basic elements of support for U.S. peanut prices and farmer income are government loans and strict limits on domestic supply by means of poundage quota and the Section 22 quota, which is a virtual ban on imports. The Food Security Act of 1985 authorizes the Secretary of Agriculture to establish annually a national poundage quota limiting the amount of peanuts that may be grown for domestic edible use. This national quota is assigned to specific areas of the country. Portions of the quota are then assigned to individual growers who cannot transfer those growing rights across county lines. Thus, over half of the farmers who grow quota peanuts must lease the quota rights from peanut-farm owners who are not necessarily farmers.

The domestic production restrictions serve to limit supply and raise prices only when backed by a strict limitation on imports. The Section 22 quota on imported peanuts allows a mere 900 short tons to be imported annually--less than 0.1% of total U.S. consumption. The poundage quota combined with the import quota creates an artificial shortage in the domestic supply. This, together with the U.S. Department of Agriculture's ("USDA") current loan level of about $617 per short ton, drives up the price for "quota peanuts" (peanuts grown for domestic edible use) to about $650 per short ton as compared to the average world price equivalent in 1989 of $332 per short ton. The USDA floor price for peanuts represents approximately a fifty percent return on the farmer's investment. As a result, the U.S. farmer grows for domestic consumption only, and the international market serves merely as a market for residual production.

#### 2. Domestic Peanut Production

The current system of national poundage quota depresses peanut production directly and indirectly. The purpose of the system is to limit sharply the domestic supply of peanuts thus putting upward pressure on the price. Each year, USDA estimates domestic demand for edible peanuts and sets the quota accordingly. However, in six of the last seven years, the U.S. Department of Agriculture has set the internal quota at a level significantly below U.S. demand. In order to meet their basic demand, buyers must purchase peanuts from the U.S. government loan inventory at a price nearly ten percent above the already-high support price. In 1987, peanuts available at the support price totaled 2.567 billion pounds versus a demand of 2.8 billion pounds. The 1988-89 estimate again indicates a shortfall of about 250 million pounds.

The two-tiered system also limits indirectly the domestic supply of peanuts. Under the internal quota system, certain farms, chosen decades ago, were allocated shares of the national poundage quota. Under this quota, USDA fixes the amount of peanuts that can be sold each year for edible use in the United States. Any farmer can grow peanuts. However, only output from quota farms can be used for domestic edible consumption and, therefore, qualify for Government's high support price. The production quota system locks production onto some of the most inefficient peanut-growing land. Approximately twenty-five percent of the quota acreage yields 1,700 pounds or less per acre with an average cost of $0.23 per pound.

These poundage quotas exclude more than one million acres that are capable of producing 2,500 to 3,000 pounds per acre at costs of only $0.17 to $0.19 per pound. The marketing quota includes land that has been depleted of nutrients and has insufficient water supplies, and, therefore, is capable of yielding only 1,200 to 1,500 pounds per acre. By simply deregulating production and thus directing the farming to more suitable land, U.S. peanut production could be increased substantially.

### 3. Domestic Price

The allocation of production to marginal land also contributes to exaggerated production cost estimates. USDA relies on its cost estimates to calculate the support price. Because many of the quota-farms are poorly suited to produce peanuts, USDA cost estimates are artificially increased by $0.01 to $0.02 per pound. In a free market, U.S. production costs in 1988 would have been closer to $0.18 to $0.19 per pound rather than the $0.205 calculated by USDA. Nevertheless, even these inflated cost estimates are well below U.S. price support levels.

Every year the U.S. support price for quota peanuts far exceeds production costs. In 1988, the support price was fifty percent above production costs as calculated by USDA. However, as noted earlier, because of the insufficient quota, the price paid by consumers is actually sixty percent above production costs because they must pay an extra ten percent over the support price to entice the growers to deliver peanuts to the commercial market rather than to the Commodity Credit Corporation.

World prices are much closer to U.S. production costs than to the support price. If the peanut import quota were eliminated, U.S. domestic prices would fall at least to the level of the inflated USDA cost estimate. Assuming a continuation of the quota system, in 1991, we project that the world price would approximate $0.205 per pound due to U.S. dumping of residual peanuts. The high domestic price acts as a subsidy, and the subsidy from the domestic market allows exports at prices approximately seven to ten percent below cost.

In a free market, however, the world price would rise to $0.224 per pound as foreign and domestic buyers compete in the same market. This translates into a reduction in the price of shelled peanuts by at least thirty percent. Domestic consumers would save a total of $378 million on 2.35 billion pounds of peanuts.

### 3. Increased U.S. Production

If the United States continues to use the two-tiered price support system for peanuts. It is unlikely that peanut production will increase above the current 4 billion pound level. Recently, yields have been declining, in part because of a reduction in the use of certain yield-enhancing chemicals. However, the quota program itself is slowly reducing yields. As land is locked into production, crop rotation becomes less profitable and crop diseases become more prevalent. Domestic consumption, regardless of price supports, will continue to increase at a rate of at least one percent due to population growth. Exports would remain in the 700 to 750 million pound range.

In contrast, under a free market, U.S. production would be expected to increase substantially. Although domestic prices would fall from $0.336 to $0.224, U.S. growers would be less reluctant to rotate crops and new more efficient acreage would be brought into production. Inefficient producers with production quotas would devote their land to other uses, while efficient producers with no quota allotment would be more likely to plant peanuts. In a free market, we project that production would be about 4.4 to 4.5 billion pounds.

### 5. Export Earnings

Increased export earnings for U.S. growers may be among the most significant effects of elimination of the import quota. The current system discourages production for export, because the U.S. grower will produce for the high support price. Residual production is then sold on the world market at a price that in most years does not cover the farmer's production costs.

Under the free market, the United States would no longer be able to dump peanuts on the world market at prices below production costs. Elimination of the U.S. import quota, and hence the de facto domestic subsidy, would increase the world price from $0.205 per pound to $0.224 per pound--in 1991, that would be an increase of nine percent. This increase would make the export market more attractive to the U.S. grower.

Enough suitable land exists in the United States to produce 4.4 billion pounds at a cost equal to or less than $0.18 to $0.27 per pound in 1988. The United States would be able to increase production since per acre yield would increase from better crop rotation, retirement of low-yielding farms, and entry of new lands previously ineligible for quota allotments.

With output at 4.4 billion pounds, U.S. export tonnage should increase to 385,000 metric tons. The export value would rise from $280 million to $348 million, or twenty-eight percent of the world export market. Even if production failed to respond and export tonnage dropped, the higher world price resulting from an absence of U.S. dumping would improve U.S. export values by $7 million.

Elimination of the U.S. peanut import quota and the U.S. peanut program would have a definite positive impact on the U.S. economy. The peanut quota is one of the most egregious examples of agricultural protectionism in the United States. The two-tiered price system used to protect peanut farmers results in inefficient production, inflated prices for the consumer, and minimal export earnings for the United States. Any price support that current peanut framers might need during the transition from a closed to open market can be provided through tariffs. Tariffs would offer a buffer to the farmers at a minimum expense to U.S. consumers.

# THE ECONOMIC CONSEQUENCES OF ENDING THE U.S. IMPORT QUOTA ON PEANUTS

## INTRODUCTION

U.S. domestic peanut prices have been supported for more than fifty years by various government programs. Most recently, The Food Security Act of 1985 features a two-tiered loan mechanism and a national poundage quota limiting the quantity of peanuts that may be grown for domestic edible use. This support mechanism for domestic peanut prices is protected by a quantitative restriction on peanut imports under Section 22 of the Agricultural Adjustment Act of 1933. The import quota, which allows less than 0.1 percent of total use to be imported, allows the price support mechanism to operate.

Since a number of countries produce peanuts for the world market at prices well below the U.S. price support (currently $615.87 per ton for domestic edibles), the elimination of the peanut import quota would open the U.S. market to foreign supplies.[1] In a free-market scenario, the U.S. domestic market would be able to import peanuts at prices below the U.S. price support which would cause internal prices to decline. How far would U.S. prices decline? What would happen to world market prices? Would U.S. production rise or fall in a free market? What would happen to the quantity and value of U.S. peanut exports/imports? If domestic prices decline, what would happen to U.S. consumption? Would foreign peanut producers such as Argentina and China benefit and by how much?

This study examines the likely economic impact of ending the U.S. quantitative import restriction which would make ineffective the price support and national poundage quota mechanisms. The major findings of the study are:

(1) U.S. peanut production would rise. The current poundage quotas lock land into production and disturb natural rotations. Diseases have become difficult to control in some areas and yields have declined. A free market would allow additional prime growing land to produce for the domestic as well as the world market raising yields and production.

(2) The U.S. consumer would save more than $375 million. The current program sets the farm support price at least 50 percent above the costs of production. In addition, the U.S. Government's national poundage quota is set too low which forces the consumer to pay an additional 7 to 10 percent above the support price. The elimination of the import quota would reduce shelled peanut prices by at least 30 percent.

(3) U.S. peanut export earnings could rise by $68 million. The current system is not export oriented. U.S. peanut exports are a residual after domestic requirements are satisfied. Consequently, the U.S. is not a reliable supplier to the world market. U.S. exports are highly unstable fluctuating between 176,000 and 630,000 tons during the last six years. In a free-market, world prices would be higher on average (as U.S. dumping would be eliminated) and the volume of U.S. exports would stabilize and probably increase as U.S. peanut production will rise in a non-quota market.

(4) Foreign suppliers would have an opportunity to increase their export earnings by as much as $75 million. The current two-tiered loan program in the U.S. subsidizes the dumping of U.S. peanuts into the world market during years of normal or above normal yields. The dumping depresses world prices below U.S. production costs and the world market equilibrium. The elimination of the dumping would increase export values by $75 million.

The sections of the study which follow examine the questions listed above and present the major findings. The first section analyzes the inadequacy and price effects of the national poundage quotas which have been set by the U.S. government since 1983. The second section reviews U.S. production costs for the 1981-1988 period and forecasts costs for 1991 -- the first year after the current program ends.[2] The third section compares U.S. production costs to U.S. and world prices with forecasts to 1991. The next section reviews the role of the U.S. as a major supplier of peanuts to the world market. Peanut production and export shares for other major producers are also reviewed. The last section of the report forecasts the economic impact of eliminating the U.S. peanut import quota on prices, supplies, demand and exports.

## INADEQUACY OF U.S. NATIONAL POUNDAGE QUOTA

The U.S. Government has isolated its domestic peanut market from the world market by an import quota which allows only 0.1 percent of its domestic use to be imported. In addition, the

Government limits the quantity of peanuts that can be grown for the U.S. market through an internal quota system. Certain farms, chosen decades ago, are allocated shares of the national poundage quota which determines the amount of peanuts that can be sold for edible use in the United States. Any farmer can grow peanuts, but only output from quota farms can be used for domestic edible consumption and, therefore, qualify for the Government's high price support. The 1989 price support for quota peanuts is set at $615.87 versus a world price of $332 per farmer stock ton.[3]

One of the major deficiencies of the current program is that the U.S. Department of Agriculture, the agency which determines the annual internal quota, has set the quota at a level below U.S. demand in six of the last seven years. A low quota forces buyers to retrieve peanuts from the U.S. Government's loan inventory at a price nearly 10 percent above the support price. Consequently, edible peanuts in the U.S. often cost more than the high price support level.

Table 1 and Charts 1 and 2 present historical data on the U.S. quota poundage and demand levels for the 1978-1988 crop years. Since the Agriculture and Food Act of 1981 was passed, the quantity of peanuts available through the national poundage quota has fallen short of demand for food and seed in six of the last seven years. In 1987, the peanuts available at the support price totaled 2.567 billion pounds versus demand of 2.800 billion -- a 10 percent shortfall. The 1988/89 estimate again indicates a shortfall of 250 million pounds. The deficiency forces U.S. consumers to pay an additional 10 percent above the support price (an extra $62 per ton) for the peanuts purchased from the Commodity Credit Corporation (CCC).

In order to gain perspective with regard to the impact the U.S. Government's peanut program has on domestic prices, output and demand as well as its impact on the world market, the next two sections review U.S. production costs and the relationships between U.S. internal peanut prices and world prices.

## U.S. PEANUT PRODUCTION COSTS

This section of the report examines U.S. peanut production costs and compares them with the minimum price support established through legislation. USDA production cost data for 1981-1987 is presented in Table 2 along with estimates for 1988.

According to USDA figures, total U.S. production costs (including economic returns to land, capital and labor) have fluctuated between 17.0 and 20.7 cents ($340-$430 per short ton) during the 1980's. In those years in which yields exceeded 2,600 pounds per acre (1981, 1982, 1984, 1985), U.S. production costs were below $400 per ton ($342-$388). In years when yields fell below 2,500 pounds, USDA information indicates that production costs exceeded 20 cents per pound and ranged from $410 to $430 per short ton.

There are strong arguments which support the thesis that the USDA figures overstate actual production costs, especially if the production and import quotas were eliminated. First, land prices are inflated by the quotas. U.S. farm income per acre in peanuts exceeds income from all other competitive crops by a wide margin.[4] The high returns in peanuts brought about by the quota program inflate land costs and, therefore, production costs.

In addition to the inflated land values, the domestic production quota inflates production costs in another way. Quota allocations are based on acreage allotment patterns established in the 1950's with only minor modifications since. Approximately 25 percent of the quota acreage yields 1,700 pounds or less per acre with an average cost of 23 cents per pound. Quotas exclude more than one million acres capable of producing 2,500-3,000 pounds per acre with costs of 17-19 cents per pound.

The production quota system combined with the high price support has locked in nutrient-depleted soils and farms short of water capable of yielding only 1,200-1,500 pounds per acre.[5] Other acreage, often in the same state and region, which could yield up to 3,000 pounds has been excluded. Consequently, USDA cost estimates are biased upward by 1 to 2 cents per pound. Free market U.S. production costs in 1988 would be closer to 18-19 cents per pound rather than 20.5 cents. However, even the higher USDA cost estimates are significantly below U.S. price support levels which are compared in the next section.

## U.S. PRODUCTION COSTS -- U.S. AND WORLD PEANUT PRICES

Table 3 and Chart 3 present historical information plus 1989-1991 forecasts for U.S. production costs, farm prices, the quota support price, the farmer stock value of world prices and the Rotterdam price of U.S. peanuts. The production cost figures have been taken from Table 2.

### U.S. Prices 50-60 Percent Above Production Costs

Chart 3 compares the U.S. support price with USDA estimates of production costs and the world price expressed in terms of farmer stock. The U.S. support price for quota peanuts far exceeds production costs in every year. In 1988, the support price is 50 percent above production costs using the USDA format. The actual price paid by consumers is 60 percent above costs because of the extra 10 percent paid to redeem peanuts from the loan as a result of the quota shortage.

It is clear that U.S. domestic prices will fall if the peanut import quota were eliminated. One could expect U.S. prices for edible peanuts to at least decline to the fully loaded USDA cost estimate. This study's 1991 forecast of U.S. production costs has been set at 22.4 cents -- approximately 4 percent above the 1987 USDA estimate and 9 percent above the 1988 figure. The forecast assumes 3 percent annual growth in costs. Costs have experienced a slight upward trend during the 1980's as various growth enhancers have been eliminated. Quality and health concerns have forced farmers to forego the use of various chemicals which have reduced yields and increased costs. The upward trend in costs is expected to continue during the next three years.

## U.S. Production Costs and World Prices

In order to compare the relationship between U.S. production costs and world prices, Rotterdam CIF prices have been adjusted back to farm prices in the U.S. (the next to last column in Table 3). Adjustments for transportation, shelling costs, the value of the oil stock and the difference between metric and short tons have been made. The information in Chart 3 indicates that the farmer stock value of world prices is much closer to U.S. production costs than is the support price. A key point to note is that world prices drop below U.S. production costs in those years in which the U.S. experiences favorable yields--especially 1984/85 and 1988/89. Even though U.S. production costs fell in both years, world prices fell even further.

One factor depressing world prices in 1984/85 was the large increase in the supply of U.S. peanuts. High U.S. crop yields in 1984/85 increased U.S. production from 3.3 to 4.4 billion pounds. U.S. exports increased from 744 to 860 million pounds in 1984/5 and to 1.043 billion in 1985/86. A significant quantity of peanuts was exported in 1984/85 at prices below U.S. production costs. The high support price for edibles ($550 per ton of farmer stock) subsidized the sale of peanuts into the world market ($280 per ton).

The same will be true in 1988/89. Although data is not complete for the current year, world prices have averaged $332 per farmer stock ton versus estimated production costs of $410. Again, U.S. production has increased -- from 3.6 to 4.0 billion pounds -- and the USDA forecasts that U.S. exports will increase. Because of the high subsidy for domestic edibles, farmers can afford to sell part of their crop into the world market at price levels below costs.

However, if the quota system is maintained, the 1991 world price would approximate 20.5 cents instead of 22.4 cents due to U.S. dumping.[6] A subsidy from the domestic market would allow exports at prices approximately 7 to 10 percent below cost. In a free market, foreign buyers would compete on an even playing field with U.S. buyers for U.S. production. There would no longer be a high domestic price to subsidize foreign sales. World prices for U.S. peanuts would reflect U.S. production costs (estimated at 22.4 cents per pound). In a free market, the world price would have to rise to 22.4 cents as foreign and domestic buyers compete in the same market.

In order to forecast the impact of a free market in 1991, a brief review of world production and export shares by major producer follows.

## WORLD PRODUCTION AND EXPORTS BY MAJOR PRODUCER

### World Production Shares, 1980-1988, 1989-1991

Table 4 and Chart 4 present 1980-1988 historical data for peanut production by major producer.[7] Historically, India has been the largest peanut producer in the world. However, China has been expanding production and ranked first in 1985/86 and 1987/88. Production shares for the two largest producers are generally close to 30 percent each.

The U.S. is the third largest producer with 1.6-2.0 million tonnes. The U.S. share of world production has been relatively stable at 8 to 10 percent during recent years.

Although Argentina is not a major producer of peanuts, it is one of the world's largest exporters. Argentine peanut production totals approximately 500,000 tonnes in a normal year-- approximately 2 percent of the world total. A drought in 1988 reduced Argentine output to only 270,000 tonnes -- 1 percent of the world total.

Other major producers include Brazil, Senegal, South Africa and the Sudan. None of these countries, however, are significant exporters.

World peanut production is expected to grow at a rate of 1 to 2 percent per year with each of the major producers maintaining their approximate shares in 1991 [i.e., India (30%), China (31%), Argentina (2%) and the U.S. (8%)].

### World Export Shares, 1980-1988, 1989-1991

Table 5 and Chart 5 present historical export tonnage for the major exporters plus 1989-1991 forecasts. Historically, China has been the largest exporter with 20 to 30 percent of the world market. However, U.S. exports exceeded China's between 1981/82 and 1985/86. At present, U.S. exports account for 24-26 percent of the world total. Argentina is the third largest exporter with 12 to 14 percent in normal years.

Generally, the three major exporters account for 60 to 70 percent of world exports. Chinese and Argentine exports have grown faster than total exports during the 1980's. In the next few years, exports from these two producers will keep pace with or exceed the growth in world exports (2 percent).

The 1991 forecast for U.S. exports will be determined by U.S. supplies and whether or not the U.S. is in the free market or still under a quota program. Under the quota program, U.S. exports will total approximately 340,000 tonnes given normal yields and account for 25 percent of the world export market. In a free market, U.S. exports are likely to reach 385,000 tonnes, as will be explained later. In the free market scenario, U.S. exports could account for 28 percent of the world export market. U.S. peanut production and exports will be an important determinant of the world price.

## WORLD PRICES FOR U.S., ARGENTINE AND CHINESE PEANUTS

Table 6 and Charts 6 and 7 compare U.S., Argentine and Chinese prices during the 1986-1988 period. Two sets of numbers are presented for each country. The first is the Rotterdam CIF price for shelled peanuts. The second series is the farmer stock ton price for inshell peanuts.

The data clearly indicates that U.S. peanuts are of a higher quality than the other two and command a premium of 11 to 12 cents in the Rotterdam market which translates into a 7 to 8 cent premium at the farm gate. The U.S. premium widens during periods of high prices (up to 21 cents in Rotterdam) and narrows when prices are low (2 cents).

The relationship between Argentine and Chinese prices fluctuates. In 1986, Argentine prices were at a premium to the Chinese. In 1988, the reverse was true with Chinese peanuts at a premium to Argentine peanuts. In general, however, the Argentine and Chinese price series follow each other closely.

In 1987, world prices fell to the $500-$600 range in Europe which lowered the inshell price to $175 in the U.S. and $120-$150 in the other two countries. It is extremely doubtful if prices would have fallen this low if U.S. farmers had not been subsidized by a very high domestic price. A farmer stock price of $175 in the U.S. is 8 cents per pound -- more than 5 cents below the variable costs of production (see Table 2). In fact, U.S. export sales from April, 1987 to September, 1987 were at prices well below variable costs.

The ability and willingness of U.S. producers to sell below production costs in the world market puts an extra burden on foreign suppliers. Foreign peanuts must remain at a discount to the U.S. product because of quality differences. But those differences must narrow as they did in 1987 when foreign suppliers undoubtedly are forced to sell at a loss (5-6 cents per pound at the farm gate). Again, if the U.S. were in a free market, subsidized export sales would not occur and all suppliers would benefit.

## U.S. SUPPLY/DEMAND BALANCES IN 1991, QUOTA VERSUS FREE MARKET

Table 7 presents historical U.S. supply/demand balance data for 1981-1988 with forecasts through 1991. Three forecasts are presented in 1991 -- one if the U.S. retains its current quota system (1991q) and two other forecasts if the U.S. eliminates its import quota and enters the free market (1991MY and 1991HY). The two free market forecasts are based on two production projections of either a moderate yield forecast (MY) or a high yield forecast (HY) following trade liberalization.

## 1991 Quota Forecasts

### (a) U.S. Production

If the U.S. extends its current peanut program beyond 1990, peanut production in the U.S. will remain near 4.0 billion pounds. The forecast assumes 4.1 billion (see 1991q in Table 7). Peanut yields have failed to grow during the 1980's. In fact, yields have declined as growth enhancers have been eliminated.[8] Moreover, the quota program is slowly reducing yields as land is locked into production, rotation is less than desireable and diseases become more prevalent.

### (b) U.S. Consumption

U.S. consumption of peanuts under the quota system will continue to grow at the rate of 1 percent -- equal to population. The forecast for 1991 is 2.35 billion pounds -- above the 1987/88 level of 2.257 billion but below the 1988/89 estimate of 2.50 billion pounds. The extra peanuts consumed in 1988/89 are due to large purchases of peanut butter by the U.S. Government for the school lunch program. The purchases will diminish or be eliminated in future years if the nation's cheese and dairy stocks return to normal levels. Consequently, the 1987 consumption figure was chosen as a base for the forecasts.

### (c) U.S. Exports

U.S. exports will remain in the 700-750 million pound range during periods of normal yields. A forecast of 750 million pounds is used for the quota case in 1991. A 750 million figure balances U.S. stocks which are stable near 870 million pounds.

## Free Market Forecasts, 1991 (Table 7)

### (a) U.S. Production

U.S. production in a free market is expected to increase. Although domestic prices will drop from the projected 33.6 to 22.4 cents (the U.S. production cost level, see Table 3), crop rotations will be freed, new acreage will be brought into production and diseases will be easier to control. Inefficient producers with production quotas will transfer land into other uses while efficient producers with no quota allotments will enter the peanut industry.

An earlier study by the author examined peanut production costs for 1982-1983 in seven major peanut growing states in the U.S. The study concluded that free market U.S. production would reach 4.8-4.9 billion pounds given 1981-1983 yields and costs of 15 cents per pound or less.[9] Given the elimination of various chemical yield enhancers since that time, production will be closer to 4.4-4.5 billion in a free market. For the purposes of this study, free-market output is estimated at 4.2 and 4.4 billion pounds, the moderate yield (MY) and high yield (HY) forecasts. The output from new growers entering the production stream combined with improved yields of current growers will produce marginally more than the high-cost producers that leave.

### (b) U.S. Consumption

High domestic peanut prices suppress U.S. peanut consumption well below the equilibrium level of a free market. An edible demand model for U.S. peanuts indicates that peanut use for food would jump by 220 million pounds if the domestic price in the U.S. fell from 33.6 to 22.4 cents in 1991 (a price elasticity of demand of -.3 when related to farm gate prices). Given the quota market food use forecast of 2.35 billion pounds, the 220 million pound increase would raise free-market food use of peanuts to 2.57 billion pounds (inshell).

In a free market in which U.S. consumers pay the equivalent of a farm gate price of 22.4 cents, consumer savings would total $378 million dollars on 2.35 billion pounds of purchases.[10] In fact, the extra 220 million pounds would cost less than the savings achieved and leave the consumer with additional purchasing power for other goods.

### (c) U.S. Exports

Given the production and consumption estimates for 1991, it is possible to forecast U.S. exports by balancing stocks. In recent years, stocks have averaged approximately 850 million pounds (except in years following bumper crops). If one assumes that an equilibrium stock ratio is 20-22 percent (an average value for 1981-1988), equilibrium stocks in 1991 will approximate 850-900 million pounds. The supply/demand equilibrium is satisfied in 1991 when exports total 850 million pounds given production of 4.4 billion (the high-yield case) or 700 million when output totals 4.2 billion pounds (the moderate yield scenario).

What do these export figures mean for U.S. and foreign export earnings in 1991? The next section uses the forecasts to answer this question.

## FREE-MARKET IMPACT ON U.S. AND FOREIGN EXPORT EARNINGS

Table 8 illustrates the free-market benefits to U.S. and foreign suppliers in terms of additional export earnings. In the free market case, the U.S. no longer dumps peanuts into the world market at prices below the cost of production. As discussed on page 12, the consequence is an increase in world prices at the farm gate level from 20.5 cents per pound in 1991 to 22.4 cents-- up 9 percent. These prices translate into U.S. export prices (FOB) of $825 and $905 per metric ton and Argentine and Chinese prices (FOB) of $585 and $665 per ton. As a result, foreign exchange earnings improve for all exporters.[11] It should be noted that the 11 cent discount between U.S. and foreign suppliers in the world market improves the percentage gain in the export price of foreign suppliers. A nine percent increase in increase of 12 percent (weighted for U.S. as well as Argentina and China) reduces world export demand by 3.6 percent. World exports in 1991 are assumed to be 1.380 million tonnes if the U.S. retains the quota system, but 1.330 million if the U.S. enters a free market and world prices rise by 12 percent -- a reduction of 50,000 tonnes.

### Argentine Export Values, 1991

As Table 9 indicates, Argentine export values rise by $3 million if the U.S. achieves the HY (high yield) production level of 4.4 billion pounds. If the U.S. is only able to produce 4.2

billion pounds in a free market (MY = moderate yield), Argentine exports increase by $12 million. However, Argentina's export gain will be dependent on the farmers' response to higher world prices. If Argentine farmers are more aggressive than assumed in this study (i.e., Argentine's export share remains constant), Argentine export values could increase by more than $12 million.

### Chinese Export Values, 1991

The benefits to the Chinese of U.S. quota elimination varies from $7 to $25 million depending on the U.S. production response and if one assumes a constant Chinese export share. If China is more aggressive and her export share increases, export values could increase by more than $25 million. It is possible that China and Argentina could capture most of the $75 million increase in world export values since the two countries have been the most aggressive exporters in the last decade as they are the only countries to show significant growth during the 1980's.

### U.S. Export Values, 1991

To the extent that U.S. production responds, U.S. export values will increase by up to $68 million. Enough land exists to produce the 4.4 billion pounds at costs equal to or less than 18-20 cents in 1988. It is likely that the U.S. would increase production in a free market in that yields would increase from better rotation, elimination of low-yielding farms, and the entry of new land which is ineligible for a quota allotment.

With U.S. output at 4.4 billion pounds, U.S. export tonnage would increase to 385,000 (metric) and the export value would rise from $280 to $348 million. Even if production failed to respond and export tonnage dropped, the higher price resulting from no U.S. dumping would improve the U.S. export value by $7 million.

## SUMMARY

The U.S. peanut program is expensive for the U.S. consumer, and reduces U.S. foreign exchange earnings plus the export revenues of foreign suppliers. The high price support for domestic edibles costs the U.S. consumer more than $375 million per annum. And the two-tiered price support program depresses world peanut prices as the U.S. uses the world market as a dumping ground for residual peanuts. U.S. export earnings are reduced by up to $68 million and the export earnings received by Argentina, China and other peanut exporters are reduced by $75 million.

Elimination of the U.S. import quota would push the U.S. into the world market as U.S. consumers could purchase either domestic or foreign grown peanuts. If the U.S. eliminated the national poundage quota and the price support system, U.S. production would increase from 4.0-4.1 to 4.2-4.4 billion pounds as costs of production are low enough for the U.S. to compete in the world market and to preclude the importation of peanuts except during extreme weather years.

Other benefits of U.S. entry into the free market include higher U.S. food consumption of peanuts at a lower cost. U.S. peanut prices at the farm level would drop by 50 percent or more which will increase U.S. food use of edible peanuts by 220 million pounds. U.S. exports could rise by $68 million and Argentina and China would also experience increased export earnings of $12 and $25 million, respectively.

## FOOTNOTES

[1] U.S. statistics are in short tons unless otherwise noted. World production and export statistics are in metric tons.

[2] The cost forecasts assume no major economic changes in the peanut industry.

[3] A farmer stock ton refers to a short ton (2,000 pounds) of peanuts which have not been shelled, cleaned or crushed.

[4] See USDA, ERS, "Economic Indicators of the Farm Sector," ECIFS 7-3. Residual returns to management and risk in peanuts averaged $149 per acre in 1985-1987 versus -$3 in soybeans, -$50 in corn, -$37 in wheat. The residual returns are in addition to a net land return of $84 for peanuts versus $46 for soybeans, $42 for corn and $27 for wheat.

[5] The acreage information has been obtained from discussions with government and industry personnel in Georgia, Florida, North Carolina, Virginia and Texas.

[6] The forecasts are consistent with the experience during the 1980's. Except for the drought years of 1983/84 and 1987/88, world prices for U.S. peanuts averaged 7 to 10 percent less than U.S. production costs.

[7] All tonnage figures in this section of the report are metric.

[8] Various industry experts indicate that the elimination of the growth enhancing chemicals have reduced yields by 200 to 300 pounds per acre since 1984. The acreage using the growth enhancers was all irrigated land.

[9] Bateman, Merrill J. and Oveson, Richard M., "U.S. Peanut Production Costs by Country," 1985.

[10] This figure assumes a wholesale market price for shelled peanuts of $770 per short ton. This figure is obtained by adding shelling costs, subtracting the oil stock value and adjusting for the ratio of edible kernels per ton of unshelled peanuts.

[11] The FOB prices are $77 less than the Rotterdam CIF prices. Transport costs are assumed to be $77 per metric ton between the origins and Europe. The edible kernel outturn in the U.S. and China is assumed to be 68.8 percent while the ratio is 60 percent in Argentina. The value of oil stock in the U.S. and China is assumed to be $25 per farmer stock ton (short) and $54 in Argentina. Shelling costs are assumed to be $140 per short ton of farmer stock.

TABLE 1
U.S. SUPPLY/DEMAND BALANCE
FOR EDIBLE PEANUTS
(Million Lbs., Inshell)

1978 - 1988

| | Quota Poundage* | | -----Domestic Demand---- | | | Supply /Demand |
|---|---|---|---|---|---|---|
| Year | Potential | Available | Food** | Seed | Total | Balance |
| 1978 | 3360 | 3024 | 1996 | 284 | 2280 | 744 |
| 1979 | 3376 | 3156 | 2028 | 271 | 2299 | 857 |
| 1980 | 3142 | 2034 | 1597 | 505 | 2102 | -68 |
| 1981 | 3486 | 2879 | 1849 | 795 | 2644 | 235 |
| 1982 | 2640 | 2426 | 2015 | 463 | 2478 | -52 |
| 1983 | 2564 | 2329 | 2023 | 564 | 2587 | -258 |
| 1984 | 2493 | 2323 | 2083 | 199 | 2282 | 41 |
| 1985 | 2420 | 2268 | 2205 | 826 | 3031 | -763 |
| 1986 | 2076 | 2459 | 2260 | 295 | 2555 | -96 |
| 1987 | 2982 | 2567 | 2258 | 542 | 2800 | -233 |
| 1988 | 3085 | 2703 | 2500 | 453 | 2953 | -250 |

* Potential quota poundage includes the national quota plus undermarketings. Quota poundage available is the quantity delivered to the shellers less the amount placed under loan.

Source: USDA, ERS, "Oil Crops: Outlook and Situation Report," various issues.

TABLE 2
U.S. PEANUT PRODUCTION COSTS
1981 - 1987

| Costs per Planted Acre ($) | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988e |
|---|---|---|---|---|---|---|---|---|
| Variable (1) | 322 | 308 | 306 | 327 | 312 | 305 | 322 | 330 |
| Machinery (2) | 53 | 57 | 60 | 60 | 53 | 55 | 55 | 55 |
| General Overhead (3) | 31 | 27 | 28 | 29 | 24 | 38 | 35 | 35 |
| Total Economic Costs | 406 | 392 | 396 | 416 | 390 | 398 | 413 | 420 |
| Cost per Pound | | | | | | | | |
| Variable | .122 | .117 | .131 | .115 | .113 | .130 | .141 | .134 |
| Other | .032 | .032 | .038 | .032 | .028 | .039 | .040 | .037 |
| Total Economic Costs (W/O Land) | .154 | .149 | .169 | .147 | .141 | .169 | .181 | .171 |
| W/ Land | .194 | .185 | .205 | .179 | .171 | .207 | .215 | .205 |
| Yield per Planted Acre | 2630 | 2626 | 2350 | 2828 | 2772 | 2354 | 2281 | 2460 |

Source: USDA, ERS, "Economic Indicators of the Farm Sector - Costs of Production, various issues.

## TABLE 3
## PAST AND PROJECTED U.S. PEANUT PRODUCTION COSTS AND PRICES GIVEN THE U.S. PEANUT PROGRAM
(Cents per Pound, Inshell)
1981-1991

| | USDA U.S. Prod'n Costs | | Farm | Support | World Price | |
|---|---|---|---|---|---|---|
| | w/o Land | w/ Land | Price | Price | U.S. Cents/Lb. | Rott. $/MT* |
| 1981/82 | 15.4 | 19.4 | 26.9 | 22.8 | 20.1 | 900.0 |
| 1982/83 | 14.9 | 18.4 | 25.1 | 27.5 | 19.6 | 885.0 |
| 1983/84 | 16.9 | 20.5 | 24.7 | 27.5 | 22.3 | 980.0 |
| 1984/85 | 14.7 | 17.9 | 27.9 | 27.5 | 14.0 | 713.0 |
| 1985/86 | 14.1 | 17.1 | 24.4 | 28.0 | 18.3 | 857.0 |
| 1986/87 | 16.9 | 20.7 | 29.2 | 30.4 | 17.5 | 836.0 |
| 1987/88 | 18.1 | 21.5 | 27.7 | 30.4 | 22.1 | 990.0 |
| 1988/89e | 17.0 | 20.5 | 27.0 | 30.8 | 16.6 | 813.0 |
| Forecasts (@ 3%)** | | | | | | |
| 1989/90 | 17.5 | 21.1 | 27.8 | 31.7 | 19.4 | |
| 1990/91 | 18.0 | 21.7 | 28.6 | 32.7 | 19.9 | |
| 1991/92 | 18.6 | 22.4 | 29.5 | 33.6 | 20.5 | |

* Shelled

** Assuming continuation of the current U.S. peanut program.

Source: Costs of Production: USDA, ERS, "Economic Indicators of the Farm Sector - Costs of Production," various issues.

Farm and Quota Support Prices: USDA, ERS, "Oil Crops - Situation and Outlook Report," January, 1989.

World Price: USDA, FAS, "World Oilseed Situation and Market Highlights," various issues. U.S. price (fob) for a pound of peanuts (inshell) derived from world price.

## TABLE 4
## WORLD PEANUT PRODUCTION
(Million Metric Tons, Inshell)
1985/6 - 1988/9

| | | | | | | | | | -------FORECASTS------- | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Country | 1980/1 | 1981/2 | 1982/3 | 1983/4 | 1984/5 | 1985/6 | 1986/7 | 1987/8 | 1988/9 | 1989/90 | 1990/1 | 1991/2 |
| U.S. | 1.04 | 1.81 | 1.56 | 1.50 | 2.00 | 1.87 | 1.68 | 1.64 | 1.81 | 1.81 | 1.86 | 1.86 |
| otal Foreign | 15.16 | 18.09 | 16.06 | 17.11 | 18.05 | 18.67 | 18.75 | 18.08 | 19.75 | | | |
| Argentina | .24 | .27 | .25 | .33 | .27 | .44 | .52 | .45 | .27 | .45 | .48 | .50 |
| Brazil | .31 | .31 | .25 | .22 | .34 | .22 | .19 | .17 | .14 | | | |
| China | 3.60 | 3.83 | 3.92 | 3.95 | 4.82 | 6.66 | 5.88 | 6.17 | 5.80 | 6.20 | 6.50 | 6.80 |
| India | 5.01 | 7.22 | 5.28 | 7.09 | 6.44 | 5.12 | 6.06 | 4.80 | 7.30 | | | |
| Senegal | .52 | .88 | 1.11 | .57 | .56 | .59 | .84 | .93 | .69 | | | |
| South Africa | .31 | .12 | .09 | .07 | .20 | .11 | .12 | .21 | .22 | | | |
| Sudan | .71 | .84 | .50 | .41 | .39 | .28 | .45 | .40 | .40 | | | |
| Others | 4.46 | 4.62 | 4.66 | 4.47 | 5.03 | 5.25 | 4.69 | 4.95 | 4.93 | | | |
| World | 16.20 | 19.90 | 17.62 | 18.61 | 20.05 | 20.54 | 20.43 | 19.72 | 21.56 | 21.75 | 22.00 | 22.25 |

Production Shares -- %

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| U.S. | 6 | 9 | 9 | 8 | 10 | 9 | 8 | 8 | 8 | 8 | 8 | 8 |
| otal Foreign | | | | | | | | | | | | |
| Argentina | 1 | 1 | 1 | 2 | 1 | 2 | 3 | 2 | 1 | 2 | 2 | 2 |
| Brazil | 2 | 2 | 1 | 1 | 2 | 1 | 1 | 1 | 1 | | | |
| China | 22 | 19 | 22 | 21 | 24 | 32 | 29 | 31 | 27 | 29 | 30 | 31 |
| India | 31 | 36 | 30 | 38 | 32 | 25 | 30 | 24 | 34 | | | |
| Senegal | 3 | 4 | 6 | 3 | 3 | 3 | 4 | 5 | 3 | | | |
| South Africa | 2 | 1 | 1 | 0 | 1 | 1 | 1 | 1 | 1 | | | |
| Sudan | 4 | 4 | 3 | 2 | 2 | 1 | 2 | 2 | 2 | | | |
| Others | 28 | 23 | 26 | 24 | 25 | 26 | 23 | 25 | 23 | | | |
| orld | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Source: USDA, FAS, "World Oilseed Situation and Market Highlights," FOP 10-88, October, 1988 plus telephone conversation with USDA, FAS, April 28, 1989.

Forecasts: Commodity Information, Inc.

TABLE 5
WORLD PEANUT EXPORTS
(Inshell. 000 Metric Tons)
1980/1 - 1991/92

| untry | 1980/1 | 1981/2 | 1982/3 | 1983/4 | 1984/5 | 1985/6 | 1986/7 | 1987/8 | 1988/9 | 1989/90 | 1990/1 | 1991/2 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| U.S. | 228 | 261 | 309 | 337 | 390 | 473 | 301 | 280 | 318 | 340 | 340 | 318 |
| | | | | | | | | | | No Quota-HY | | 386 |
| Total Foreign | 914 | 746 | 779 | 617 | 706 | 893 | 944 | 1030 | 982 | | | |
| Argentina | 74 | 64 | 111 | 121 | 117 | 186 | 170 | 160 | 100 | 170 | 180 | 190 |
| Brazil | 37 | 19 | 13 | 12 | 20 | 12 | 8 | 8 | 15 | | | |
| China | 305 | 157 | 232 | 160 | 212 | 333 | 398 | 359 | 350 | 370 | 385 | 405 |
| India | 71 | 46 | 35 | 60 | 40 | 15 | 40 | 10 | 50 | | | |
| Malawi | 13 | 10 | 6 | 2 | 13 | 20 | 20 | 42 | 38 | | | |
| Senegal | 3 | 6 | 0 | 0 | 0 | 0 | 25 | 31 | 30 | | | |
| South Africa | 52 | 39 | 5 | 6 | 47 | 21 | 1 | 37 | 50 | | | |
| Sudan | 133 | 131 | 70 | 51 | 15 | 11 | 10 | 75 | 75 | | | |
| Others | 226 | 274 | 307 | 205 | 242 | 295 | 272 | 308 | 274 | | | |
| World | 1142 | 1007 | 1088 | 954 | 1096 | 1366 | 1245 | 1310 | 1300 | 1325 | 1350 | 1380 |
| | | | | | | Export Shares | | | | | | |
| U.S. | 20 | 26 | 28 | 35 | 36 | 35 | 24 | 21 | 24 | 26 | 25 | 23 |
| | | | | | | | | | | | | 28 |
| Total Foreign | | | | | | | | | | | | |
| Argentina | 6 | 6 | 10 | 13 | 11 | 14 | 14 | 12 | 8 | 13 | 13 | 14 |
| Brazil | 3 | 2 | 1 | 1 | 2 | 1 | 1 | 1 | 1 | | | |
| China | 27 | 16 | 21 | 17 | 19 | 24 | 32 | 27 | 27 | 28 | 29 | 29 |
| India | 6 | 5 | 3 | 6 | 4 | 1 | 3 | 1 | 4 | | | |
| Malawi | 1 | 1 | 1 | 0 | 1 | 1 | 2 | 3 | 3 | | | |
| Senegal | 0 | 1 | 0 | 0 | 0 | 0 | 2 | 2 | 2 | | | |
| South Africa | 5 | 4 | 0 | 1 | 4 | 2 | 0 | 3 | 4 | | | |
| Sudan | 12 | 13 | 6 | 5 | 1 | 1 | 1 | 6 | 6 | | | |
| Others | 20 | 27 | 28 | 21 | 22 | 22 | 22 | 24 | 21 | | | |
| World | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Source: USDA. FAS. Circular Series. FOP 10-88. October. 1988 plus information gathered by telephone from USDA. FAS.

## TABLE 6
## WORLD PEANUT PRICES
## ROTTERDAM CIF AND ORIGIN FOB

| | Rotterdam, CIF (Shelled) | | | Origin FARM (Inshell) | | |
|---|---|---|---|---|---|---|
| | $/MT | | | $/ST | | |
| | U.S. | Argentina | China | U.S. | Argentina | China |
| 1986: 1 | 708 | 660 | 585 | 279 | 231 | 202 |
| 2 | 715 | 635 | 583 | 283 | 218 | 201 |
| 3 | 715 | 615 | 580 | 283 | 207 | 199 |
| 4 | 706 | 616 | 575 | 278 | 207 | 196 |
| 5 | 867 | 735 | 644 | 378 | 272 | 239 |
| 6 | 956 | 710 | 653 | 434 | 259 | 245 |
| 7 | 1080 | 860 | 733 | 511 | 340 | 294 |
| 8 | 1346 | 1111 | 919 | 677 | 477 | 411 |
| 9 | 1215 | 1108 | 863 | 595 | 475 | 376 |
| 10 | 1585 | 1308 | 1066 | 826 | 584 | 502 |
| 11 | 1323 | 991 | 730 | 663 | 412 | 293 |
| 12 | 975 | 850 | 650 | 445 | 335 | 243 |
| 1987: 1 | 842 | 772 | 637 | 362 | 292 | 235 |
| 2 | 796 | 598 | 581 | 334 | 198 | 200 |
| 3 | 730 | 533 | 495 | 293 | 162 | 146 |
| 4 | 678 | 574 | 510 | 260 | 185 | 155 |
| 5 | 686 | 531 | 525 | 265 | 161 | 165 |
| 6 | 658 | 523 | 525 | 248 | 157 | 165 |
| 7 | 625 | 495 | 525 | 227 | 142 | 165 |
| 8 | 542 | 460 | 505 | 175 | 122 | 152 |
| 9 | 586 | 460 | 523 | 203 | 122 | 163 |
| 10 | 781 | 494 | 545 | 324 | 141 | 177 |
| 11 | 918 | 618 | 606 | 410 | 208 | 215 |
| 12 | 1048 | 685 | 636 | 491 | 245 | 234 |
| 1988: 1 | 1019 | 630 | 626 | 473 | 215 | 228 |
| 2 | 1081 | 624 | 648 | 512 | 212 | 241 |
| 3 | 1040 | 605 | 679 | 486 | 201 | 261 |
| 4 | 985 | 605 | 710 | 452 | 201 | 280 |
| 5 | 1105 | 656 | 815 | 527 | 229 | 346 |
| 6 | 1148 | 720 | 859 | 553 | 264 | 373 |
| 7 | 1085 | 722 | 827 | 514 | 265 | 353 |
| 8 | 878 | 648 | 756 | 385 | 225 | 309 |
| 9 | 789 | 650 | 672 | 329 | 226 | 256 |

Source: USDA, FAS, "World Oilseed Situation and Market Highlights," October, 1988, p. 51 for Rotterdam, cif prices. Origin farm stock prices derived from Rotterdam prices by the following formula:

$$OFSP = ((RCIF - TRC)/1.1023)*EKR) + OSP - SHC$$

where:

OFSP = Origin farm stock price
RCIF = Rotterdam cif price
TRC = Transport cost ($140/MT)
EKR = Ratio of edible kernels per farm stock ton
OSP = Value of oil stock per ton of farm stock peanuts
SHC = Cost of shelling per ton

### TABLE 7
### U.S. PEANUT SUPPLY/DEMAND
(Millions of Lbs.)
1981 - 1991

| Year | Supply | | | | Disappearance* | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Beg Aug 1 | Beg Stks | Prod'n | Imports | Total | Crush* | Exports | Food* | Seed | Total |
| 1981 | 413 | 3982 | 2 | 4397 | 420 | 576 | 1849 | 795 | 3640 |
| 1982 | 757 | 3440 | 2 | 4199 | 176 | 681 | 2015 | 463 | 3335 |
| 1983 | 864 | 3296 | 2 | 4162 | 220 | 744 | 2023 | 564 | 3551 |
| 1984 | 611 | 4406 | 2 | 5019 | 453 | 860 | 2083 | 199 | 3595 |
| 1985 | 1424 | 4123 | 2 | 5549 | 630 | 1043 | 2205 | 826 | 4704 |
| 1986 | 845 | 3701 | 2 | 4548 | 327 | 663 | 2260 | 295 | 3545 |
| 1987 | 1003 | 3619 | 2 | 4624 | 374 | 618 | 2257 | 542 | 3791 |
| 1988 | 833 | 3981 | 2 | 4816 | 320 | 700 | 2500 | 453 | 3973 |
| 1989 | 843 | 4000 | 2 | 4845 | 450 | 750 | 2302 | 500 | 4002 |
| 1990 | 843 | 4100 | 2 | 4945 | 500 | 750 | 2325 | 500 | 4075 |
| | | | | Quota Forecast | | | | | |
| 1991q | 869 | 4100 | 2 | 4971 | 500 | 750 | 2350 | 500 | 4100 |
| | | | | Free Market Forecasts | | | | | |
| 1991HY* | 869 | 4400 | 2 | 5271 | 480 | 850 | 2570 | 500 | 4400 |
| 1991MY* | 869 | 4200 | 2 | 5071 | 450 | 700 | 2570 | 500 | 4220 |

* 1991HY refers to the free market forecast in which higher yields are obtained due to new land and better crop rotation. 1991MY refers to the free market forecast in which moderate yield improvements are obtained due to new land and better crop rotation.

Source: USDA, ERS, "Oil Crops, Situation and Outlook Report," January, 1989 except that Food and Crush have been adjusted for a 68.8% outturn ratio of edible peanuts per farmer stock ton rather than the 75 percent estimate used by the USDA.

### TABLE 8
### U.S., ARGENTINE AND CHINESE EXPORT EARNINGS FROM PEANUTS 1991

| Type of Market | Quantity (000 TMT) | Price* ($/MT) | Value ($Millions) |
|---|---|---|---|
| Argentine Exports | | | |
| U.S. Quota | 190 | 585 | 111 |
| U.S. HY | 172 | 665 | 114 |
| U.S. MY | 185 | 665 | 123 |
| Gain: HY | | | 3 |
| Gain: MY | | | 12 |
| Chinese Exports | | | |
| U.S. Quota | 405 | 585 | 237 |
| U.S. HY | 367 | 665 | 244 |
| U.S. MY | 394 | 665 | 262 |
| Gain: HY | | | 7 |
| Gain: MY | | | 25 |
| U.S. Exports | | | |
| U.S. Quota | 340 | 825 | 281 |
| U.S. HY | 385 | 905 | 349 |
| U.S. MY | 318 | 905 | 288 |
| Gain: HY | | | 68 |
| Gain: MY | | | 7 |

* U.S. prices are based on 22.4 cents per pound at the farm gate in a free-market and 20.5 cents per pound under a quota system.

the U.S. export price results in a 13-14 percent increase in export prices for Argentina and China.

A price elasticity of demand for world exports of -.3 has been used to determine the impact of higher prices on world consumption and, therefore, exports.[12] The overall price

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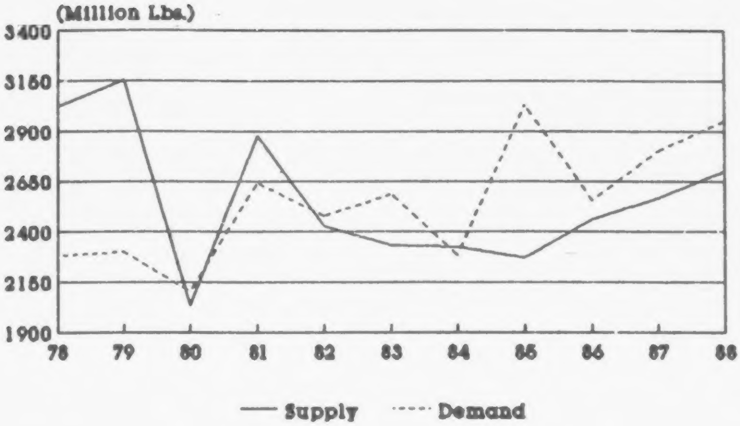
[12] The -.3 price elasticity is consistent with estimates of the U.S. price elasticity of demand and somewhat higher (in absolute terms) than the -.15 and -.20 estimates obtained by the author in other sutdies. The -.30 estimate provides a somewhat more conservative estimate of the gains to be made from the U.S. entering the free market.

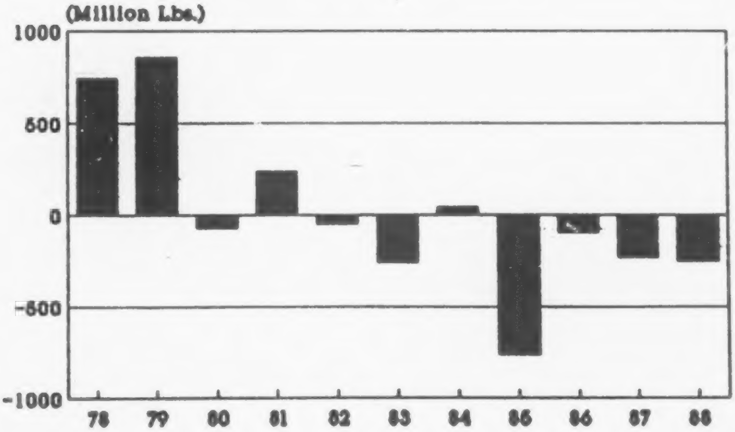
CHART 1



U.S. Supply/Demand Balance
For Edible Peanuts
1978 - 1988

Commodity Information, Inc.

CHART 2

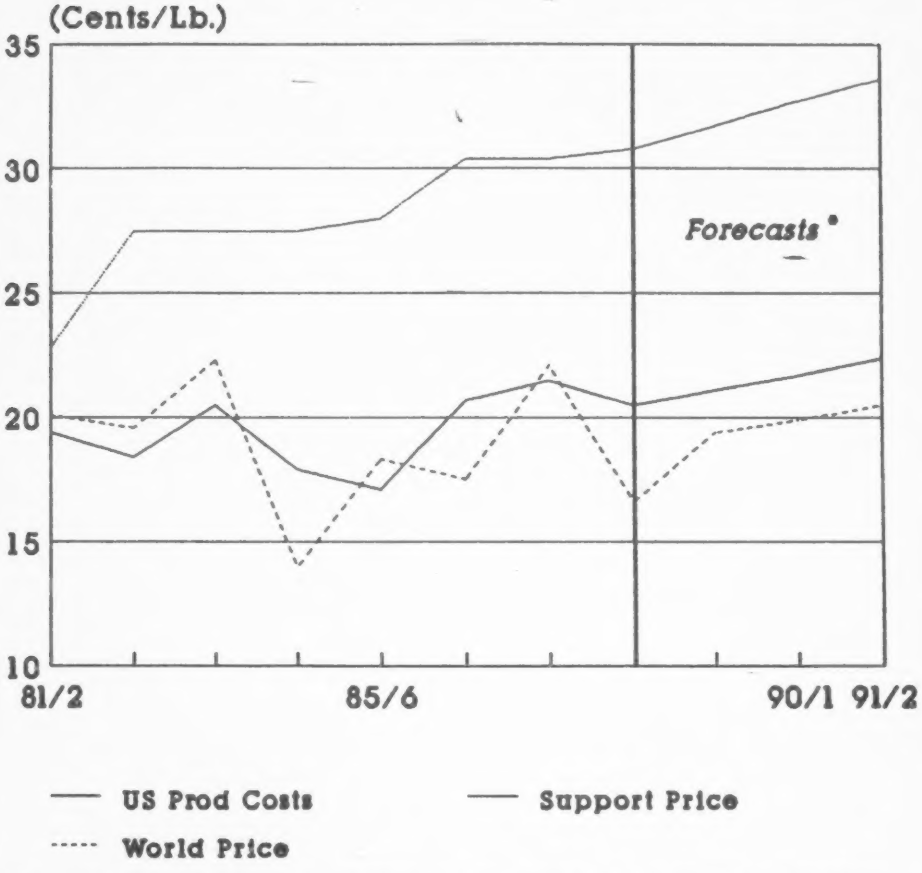


U.S. Supply/Demand Surplus/Deficit
For Edible Peanuts
1978 - 1988

Commodity Information, Inc.

CHART 3

# Peanut Prices
## (Inshell)
## 1981/82 - 1991/92

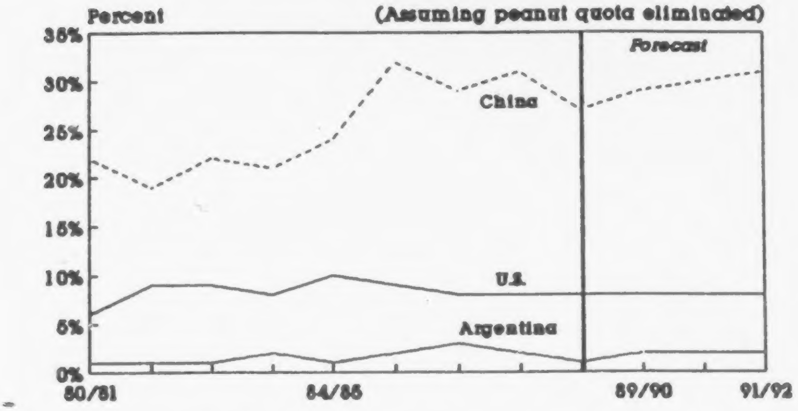


* Forecasts assume extension of current U.S. peanut program

Commodity Information, Inc.

CHART 4

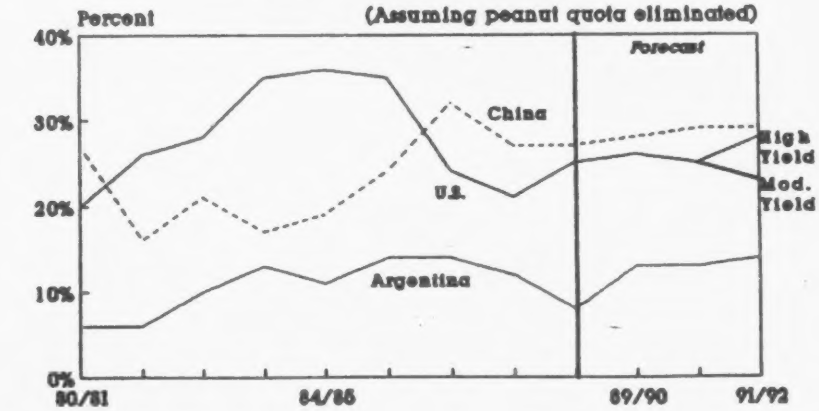
## World Peanut Production
### Production Shares
### 1980/81 - 1991/92



Commodity Information, Inc.

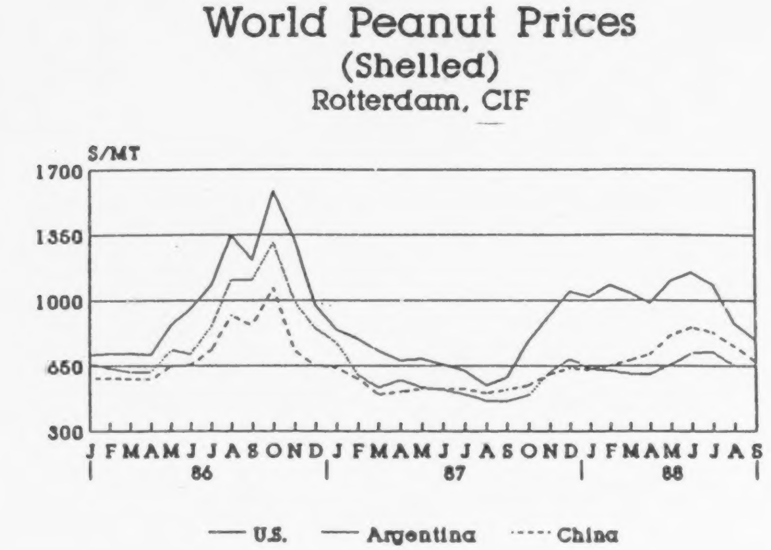
CHART 5

## World Peanut Exports
### Export Shares
### 1980/81 - 1991/92



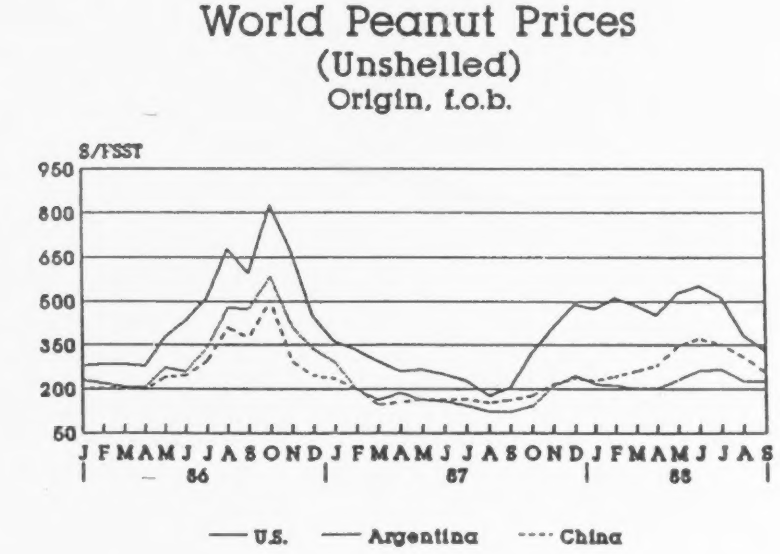
Commodity Information, Inc.

CHART 6



Commodity Information, Inc.

CHART 7



Commodity Informatinos, Inc.

Dataquest 1989 PRESIDENTS' SUMMIT CONFERENCE

TECHNOLOGY, TRADE, AND POLITICS
August 18, 1989
San Diego, California

# Commercialization of Technology in Japan --The Challenge for CEOs

Peter D Miller
Representative Director, Access Japan K K

## 1 Introduction

American innovators have become R&D workshops for Japanese competitors who have purchased for $10 billion virtually all the technology in the world worth having. As a key part of the investment required to control global markets, it's a bargain. It is a lot less than the R&D investment required to develop the technology in the first place. The videotape recorder was invented in America in 1956, licensed in Japan in 1972, and first commercialized in 1975. With it goes most of the electronics food chain, from chips to entertainment software. Try to acquire a license for leading-edge VCR production from a Japanese company -- you can't buy it at any price. This is a sensible business decision, given the size of the global electronics market:

World Electronics Market ($ billions)

| | 1988 | 1992 |
|---|---|---|
| Europe | $139 | $182 |
| Japan | $246 | $360 |
| United States | $258 | $332 |
| Other | $127 | $200 |
| Total | $770 | $1074 |

Source: Dataquest

Controlling markets of this size is more profitable in the long run than selling off assets.

For those unaccustomed to Japanese commercial and intellectual property practices, betting on commercialization of R&D in Japan is undeniably expensive and risky -- but the alternatives are costlier and riskier. In fact American corporate managers have been betting their companies -- and losing -- without realizing it. Leadership at the top is needed to turn the situation around.

I will first try to explain why this has happened, then offer a few suggestions as to how companies can improve the prospects for freely commercializing their own technologies in Japan. Finally I will describe the implications of these changes in international technology management for CEO leaderhship.

## 2 Is Japanese Competition Unfair?

Is Japanese competition unfair? Of course it is. Since capitalism began, no nation has ever become a world-class player without re-writing the rules of international competition in its own favor. In propelling itself to the front ranks of global trade, Japan has literally rewritten the book on economic growth in ways that have restructured the terms of competition forever.

Japan is not a nation of entrepreneurs. Things like stability, predictibility, keeping one's place are what matter. Accordingly the government's job is to create a risk-free environment for the expansion of industry. This is done by allocating capital to developmental targets rather than by the vagaries of interest rates. Japan has the highest savings rate and the lowest interest rates in the world, and a wonderfully efficient mechanism for channeling the savings of millions into industry. The zaibatsu launch new products with the security of a guaranteed market share from within-group sales. Japanese employees, small businesses, shareholders, and consumers subsidize international competitiveness through workaholic behavior, low margins, nonexistent dividends, and high prices respectively. Japanese consumers, for example, must work five times as long as Americans to buy half a kilogram of fish or rice, nine times as long to buy half a kilogram of beef, and three times as long for four liters of gasoline. Manufactured goods also cost more in Japan, as anyone who has compared camera prices in New York and Tokyo knows. (When some entrepreneurs started re-importing audio equipment and undercutting domestic Japanese prices, their import licenses were instantly cancelled.)

Japanese companies can invest in new plant and equipment without worrying about whether the goods can be sold. Invariably they can command exorbitant prices at home because foreign competition is negligible. And if managers over-estimate demand and build excessive capacity? No problem, the surplus can be dumped on world markets. This builds market share and eventually turns overseas markets into extensions of the domestic Japanese market. Japanese companies routinely invest whatever it takes to purchase market share, in many cases establishing a line item in the budget for this purpose. Like any other investment, it funds an asset that generates future profits, in the form of exclusive or shared ownership of a market. When the crunch comes, a government-organized cartel will allocate shares in accordance with relative positions at that time. Official policies thus in effect require Japanese firms to build market share for the long haul.

Cost control in Japan's export sector has been enforced since 1986 by endaka (Yen appreciation). In other words, a US policy intended to make Japanese manufacturers less competitive made them moreso. They rationalized operations, cut costs, automated, simplified assembly, etc. until exports could be internationally competitive even at ¥120 to the Dollar.

Japan's trade practices clearly violate the traditional rules and neoclassical economic assumptions of the international free trading system. Stuck with economic and legal dogmas that once sustained American supremacy but no longer do so, the United States is struggling to find new principles of action. No nation, not even the United States, can be expected to adhere to principles that do not serve its best interests. The unfair practices that have made Japan an economic superpower will not lightly be abandoned.

### 3 R&D in America

How well equipped are American companies are to respond to the way Japan has rewritten the rules? Standard business-school thinking holds that profit centers maximize overall corporate performance, reducing the CEO's job to portfolio management. Water-tight compartments are set up and a systematic disincentive to cooperation among them is built in. Japanese subsidiaries are particularly vulnerable to profit-center philosophy because if they fail to plough profits back into gaining market share, they will be unable to stay in the market.

The federal government spends $61 billion a year on R&D, two-thirds of it military. The one-third allocated to civilian R&D goes to projects like the space station, atom smashers, and breeder reactors ($5 billion each). Weaponry and gee-wizardry absorb many talented scientists but contribute relatively little to what consumers want to buy.

Researchers in industry tend to consider marketability, manufacturability, production cost, and customization technically uninteresting. New products or processes are developed first for the United States; information about foreign markets is rarely obtained, even if, as is increasingly the case, overseas markets are more advanced. Since Japan accounts for such a small proportion of corporate sales, designing for the Japanese market is unimportant or at most a matter of superficial cultural and language adaptation.

### 4 The Obvious Choice

Having gone through the design process without input from Japan, additional investment is required to develop the Japanese market. At that point here is how Japan usually appears: A place where the startup costs are enormous (thanks to the devalued Dollar), where customers think they're doing you a favor merely to explain what their requirements are, where the best people are locked up in lifetime-employment serfdom, where the patent system is designed to broadcast new technology rather than reserve it to inventors, and where practical legal remedies are nonexistent. For both the corporate product manager and the startup company, the difficulties of mastering a new set of strange customer requirements, setting up an international service organization, protecting the technology, and so forth are overwhelming. The corporate patent and licensing department gets nothing from such an effort. It generates revenues from licensing. An enormous investment for an uncertain result, or an immediate return on no further investment at all. For a product manager or a licensing manager, the choice of licensing is obvious. In 1987 Japanese companies spent $2 billion buying new technologies, $1.3 billion in North America, the remainder in Europe. (Acquisitions of whole companies or shares of them are additional.)

Is anything wrong with this picture? Not according to the traditional rules of free trade. This massive transfer of technology has become the obvious choice for many US companies because it's been set up to be that way. Japan is perceived as a tough market, and the perception becomes a self-fulfilling prophecy. Product and patent-licensing managers often merely react to the incentives that appear "given," without realizing their companies will soon be competing with their own licensed technologies not only in Japan, but all over the world. Especially for technology-intensive companies, this is a sure loser, because if all they have is a me-too product, competition will be based on who can sing the loudest karaoke songs. If on the other hand they choose to commercialize their own technologies in Japan, that puts the customer's decision back where it belongs -- price and performance. MITI itself found in a recent study that successful foreign companies compete in Japan on the basis of "exclusive technological strengths." Indeed that is virtually the only advantage they have in Japan over domestic companies with superior name-recognition, sales and service coverage, and zaibatsu-relationships. It is hard to understand what causes American companies to bargain away their sole advantage in Japan.

The practice has a long tradition. Bell Laboratories invented the transistor in 1947 and from 1951 sold non-exclusive licenses to anyone for $25,000 each.

For a while the federal government required AT&T to license its inventions to anyone in the world. In 1974 the US Justice Department forced Xerox to license its dominant patents to anyone worldwide, including Japanese competitors of Fuji-Xerox, who couldn't believe their good fortune. National laboratories like Livermore routinely give away hundreds of billions of dollars worth of aerospace technology and supercomputer codes for nothing. The giveaway habit is hard to break.

The management of technology, like other functional specialties, is evidently too important to be left entirely to specialists. The strategic importance of proprietary technology is best appreciated in companies that emphasize commercialization. A few American companies are designing products for markets that presently exist only in Japan (not surprisingly, this is another one of the success factors cited in the MITI study). Rockwell supplies 80 percent of the modem chips that go into facsimile machines, a product made almost exclusively by Japanese companies. MRS is designing steppers for liquid crystal display production, another market in which Japanese companies predominate. The success of the Japanese semiconductor industry has helped companies like Sun and other suppliers of workstation hardware and software for applications such as chip design, and Applied Materials, a maker of advanced semiconductor production equipment which does some design in Japan.

To see why many other American companies have failed to commercialize their own technologies in Japan, we need to understand how the Japanese patent system works.

## 5 The Japanese Patent System

Japan operates, in the words of US Patent Commissioner Quigg, the largest system of mandatory licensing in the world. The Japanese patent system works as follows:

1) The average period of patent pendency in Japan is six years, compared to 19 months in the United States and less than two years in Europe.

2) Under Japan's patent opposition procedure, patent applications are published after 18 months. Competitors therefore have an average of 4 1/2 years to examine patent applications before patent protection is granted. This is of course substantially longer than the life-cycle of most high-technology products.

3) An incredibly narrow scope of claim interpretation often grants patents to trivial or non-functional variations on innovative technology, or to items in the public domain. There is no doctrine of equivalents to prevent patents from being awarded to claims showing

only cosmetic differences from prior art, For example, a Japanese patent was awarded to a chemical compound with a non-functional one-percent difference in the proportion of an ingredient.

4) There is no effective obligation to disclose prior art in Japan. Although a patent fraud statute is on the books, it has never been enforced. Absent opposition, a Japanese patent may be granted on direct copies of prior art, regardless of the source of the original invention. This practice often places the original inventor in a position of infringing patents on his own technology in Japan.

5) These conditions cause large Japanese companies to engage in "patent flooding," the practice of overwhelming the Patent Office and potential opposers with numerous applications, many of which will be granted by default. This enables Japanese companies with sufficient patent-writing resources to establish a formidable patent position with minimal investment in R&D. There are, for example, several thousand superconductivity patent applications on file in Japan, awaiting the day when commercialization will make them valuable.

Forty-four percent of all the patent applications filed in the world are filed in Japan. In the United States, foreigners receive an average of 45 percent of all patents issued. The top ten holders of US patents issued in 1988 were:

| | Company | US Patents | | Company | US Patents |
|---|---|---|---|---|---|
| 1 | Hitachi | 907 | 6 | N Am Philips | 581 |
| 2 | Toshiba | 750 | 7 | Siemens | 562 |
| 3 | Canon | 723 | 8 | IBM | 549 |
| 4 | GE | 690 | 9 | Mitsubishi Electric | 543 |
| 5 | Fuji Photo Film | 589 | 10 | Bayer | 442 |

In Japan, the proportion of patents issued to foreigners is 17 percent.

Patent flooding tactics are frequently used to obtain technologies developed by others, whether foreign or Japanese. Inventors can oppose derivative patents, an administrative and legal process that may take five or ten years, during which sales may be threatened. A patent position established through patent flooding is typically used to drive customers away from products not covered by large numbers of Japanese or which allegedly infringe existing Japanese patents. Thus long before any legal resolution of a patent dispute occurs, a commercial threat with little or no legal foundation often exists. In many cases the claims presented to the Patent Office and to customers are so trivial that people unfamiliar with patent flooding cannot believe such claims will be taken seriously. Believe it. Even claims totally lacking technical merit can damage competing sales. Cross-licensing is usually represented as the obvious outcome of the Japanese preference for settling disputes outside the courts. In this way the Japanese patent system becomes an elaborate system of mandatory licensing.

Occasionally an article appears in the Wall Street Journal wondering why there is no venture capital industry in Japan. My friends in what passes for a venture capital industry there tell me it's because startup companies' inventions are quickly appropriated by one or more of the zaibatsus through the techniques described above. It follows that the changes in the Japanese patent system sought by the United States and other countries will benefit Japanese as well as foreign innovators.

## 6 Twelve Suggestions

Before you conclude that the situation is hopeless, let me mention a few things I have found useful. Advice on specific cases should be sought from patent counsel in Japan. From the perspective of international technology management, however, an intellectual property program that contains the following 12 elements can materially improve the situation:

1) Conduct an intellectual property audit. Find out what Japanese patents your company has applied for, have been opposed, are pending, have been awarded. Understand that US patents have little or no value in Japan.
2) Document technology and information disclosed in meetings and even in informal talks. Consider the possibility of requiring assignment of patents based on information disclosed in commercial discussions, rather than relying on standard nondisclosure agreements. Or obtain patent coverage in Japan before initiating discussions with prospective distributors or partners.
3) Ask whether more information is disclosed by filing a patent application than by sale of product. If so, consider opting for trade secret protection rather than patent protection.
4) Monitor patent applications and oppositions in key technologies.
5) Determine what is essential versus peripheral to product coverage. Don't try to emulate the patent flooding approach, it's too expensive. Instead, take advantage of the new rules permitting multiple claims in single applications.
6) Rewrite Japanese patent applications to make them as easy to understand as possible, removing extraneous material and disclosing only so much as is necessary to support specific claims. Merely translating US patents into Japanese will unnecessarily restrict the scope of claims.
7) File patent applications before inventions are reduced to practice, including improvements suggested by customers. Ideally, plan to have patents issued, not just applied for, at the time of first sales in Japan, meaning applications must be filed five or six years before sales.
8) Emphasize the features in Japanese patent applications that are most valued by Japanese customers, rather than just patenting the cleverest technology.
9) Separate multiple claims to permit later division applications while keeping the date of the original application.
10) When opposing competing or derivative patent applications, negotiate to have their claims narrowed than to eliminate the patent entirely.
11) Use the Trade Act of 1988 to keep products made with unauthorized use of US process patents out of US markets.
12) If licensing, make licenses nonexclusive to ensure broad market coverage and encourage competition among different licensees. Restrict licenses in terms of specific applications, markets, territories, sublicensing rights, and other areas.

## 7 Market Development Options

The strategic advantages of a serious competitive effort in Japan are clear -- establishing a position in the second-largest market in the world, and bringing real competition to the Japanese market to prevent its subsidizing international gains. Licensing, distribution, joint ventures, strategic alliances, sales subsidiaries, local assembly or engineering, and other options should be evaluated in terms of these strategic goals. The greater the foreign supplier's commitment to the Japanese market, measured by resources, people, and facilities in Japan, the greater attractiveness the company has for Japanese customers. Companies equipped to customize products and services in Japan through applications engineering, testing, and providing local rather than remote answers to technical questions, generally find their sales in Japan are a lot better than those who can't provide those services. And after they get finished paying for the facilities, their profits are a lot better too. Another benefit is that improvements developed in such facilities are often useable back in the United States and in other markets. Such considerations influenced Kodak recently to invest $80 million in an R&D facility in Yokohama.

Interim stages require less of an initial investment. The appeal of a trading company, joint venture, or strategic alliance to many is to turn the "Japan problem" over to someone else. But companies that treat them as an opportunity to learn about Japan get a lot more out of such operations than passive partners do. YHP is more profitable than HP, and Fuji Xerox made more money that Fuji Photo Film last year. For Western companies that approach joint ventures as a learning experience, they can provide a rich source of in-depth knowledge, customer relations, and future staff.

Many foreign suppliers start out in Japan with trading companies. Sales and service in Japan are extremely personal, hence labor-intensive functions. Sales per employee in Japan are typically half what they are in the United States. Trading companies undertake the tremendously time-consuming work of entertaining customers, catering to their whims in everything from karaoke to technical specifications, and providing whatever technical dialogue they may be capable of. That is their stock-in-trade, and they do not want suppliers to establish direct ties with customers. If suppliers find this really does not serve their long-term interests, they must provide through their own organizations the highly labor-intensive sales and service expected by Japanese customers. Kodak discovered that in order to compete, it had to show customers it deals directly in Japan. In every instance of coversion to direct or supplier-managed distribution that I have seen or been a part of, Japanese customers have welcomed the change.

## 8 Changes in the CEO Role

How can CEOs in America and Europe respond to the changes Japan has wrought in the terms of trade? By recognizing that the rules and incentives governing their companies have been made obsolete, and restructuring them to meet new requirements. By picking winners and then making them win. By investing for the long haul. By gaining the cooperation of employees, vendors, Wall Street, customers, and yes, even the government. By informing themselves and their management team as fully as possible about what is going on in Japan. By improving communication within the company between engineering and marketing people. By directing applied research specifically to commercialization and customization. By listening to your Japanese subsidiaries and joint venture partners, while getting independent. objective information, By developing a program to commercialize proprietary technologies in Japan. And above all, by bringing a corporate vision to the work of specialists.

### US firms see unfair trading by Japan over inventions

# Call for patent medicine

**By Bob Johnstone in Tokyo**

Differences in the way Japan and the US protect new inventions are becoming another focus of bilateral trade friction, with US businessmen claiming that the Japanese patent system encourages theft of US intellectual property.

US companies are particularly upset that approval of a patent in Japan can take up to seven years, compared with about two years in the US. The Japanese system requires publication of the content of a patent application after 18 months, making the invention vulnerable to copying.

Concern about such practices prompted the US Congress to pass a retaliatory revision to the Tariff Act as part of the omnibus trade bill in August. As a result, US firms no longer need provide evidence of injury before filing suits against foreign companies for violations of intellectual-property rights.

Although the heads of the European, Japanese and US patent offices met in Tokyo in the first week of November to iron out the differences between their various systems for the protection of intellectual property, Japan's problem is essentially simple — too few staff in the Japanese Patent Office (JPO) to allow its system of patent registration to handle the overwhelming demand.

Electronics research: quotas on patent ideas.

The JPO had only 890 examiners to deal with the 565,000 patent applications received last year. The European Patent Office (EPO), which administers a patent regime similar to that of Japan, employs 1,400 examiners to handle 51,000 applications a year and the US Patent and Trade Mark Office (USPTO) had more than 2,100 examiners to deal with 137,000 applications lodged last year.

Because of its policy of severe fiscal restraint, the Japanese Government has limited recruitment to 46 new examiners this year, despite a huge backlog of applications that has built up because of insufficient staff. The EPO and USPTO, by contrast, are rapidly expanding staff to cope with patent applications which have mushroomed in step with the quickened pace of technological innovations. Experts predict the world's intellectual property will double between now and the end of the century, threatening to swamp existing systems for protecting inventions in a flood of paperwork.

In Japan, the present understaffing means that a patent application on average sits three years in an in-tray before being examined — and the delay is lengthening. But unlike the US, where an application's contents remain confidential until the patent is granted, the Japanese (and the European) practice of publishing the contents of applications 18 months after receiving them, US firms contend, allows Japanese competitors to copy their ideas, then apply for patents on multiple minor variations.

The gap between publication and approval of the patent allows imitators several years to commercialise the idea with impunity; as Maryland-based Fusion Systems alleges Mitsubishi Electric did with its invention.

In 1975, Fusion applied for 20 Japanese patents on a high-intensity microwave lamp. Two years later — shortly after the publication of the contents of its applications — Mitsubishi deluged the patent office with more than 200 applications for patents on a similar lamp.

Since mounting a challenge to so many patents would be expensive, and since failing to do so could lead to charges of infringement, Fusion was under pressure to cross-license its technology to Mitsubishi. This, say the Americans, is the motivation of such patent flooding, or "nuisance filing."

Some US critics go so far as to claim that the Japanese patent system, like so much else in Japan, is designed to foster cooperation and industrial development at the expense of the proprietory rights of the inventor. The system certainly favours big companies with the resources to file large numbers of patents and fight expensive legal battles.

But the peculiarity of the Japanese patent system is not so much the system — which is similar to that in most of the rest of the world, except the US and the Philippines — but differences in industrial organisation and attitudes.

In the West, unlike Japan, small and medium-sized companies are frequently the source of innovations. Such companies made half the patent applications filed with the EPO last year. Further, the Japanese propensity to file patents originates from the systematic attitude big Japanese companies take to promoting innovation, rather than the mere desire to neutralise foreign competition.

Big Japanese companies encourage all employees to contribute ideas. At a low level, this is formalised in the *teian* system, under which employees write proposals for improvements to company operations. For each proposal, they get some sort of token, worth a nominal sum, which can be redeemed at company shops. Proposals are assessed and graded according to their usefulness. The top grades typically receive a small cash bonus and sometimes also the prestige of being featured in the company's in-house magazine. The main benefits of the system come on the production line, where a small improvement can save money.

A similar approach is applied to patent applications. "Our way of thinking [regarding innovation] is different," said Isao Hashimoto, a manager in Hitachi's patent department. "It applies not just to researchers, but to factory engineers and production people as well." Hashimoto reckons a quarter of Hitachi's 80,000-odd employees are capable of coming up with patentable inventions.

In some companies, employees are expected to produce patent ideas; quotas are even set for researchers. NEC, for example, requires each of its researchers to file half a dozen applications a year, even those working in its basic research laboratory. In general, Japanese managers seem to believe that filing several patent applications a year shows that a researcher is doing good work; they are given credit just for filing.

Few Japanese patents earn royalties. In the electronics industry, few applications ever become patents. For Hitachi, the success rate is just one in five. For Japan as a whole, only about half the applications are granted, and of these patents only 10-15% are ever put to use.

One reason for the low implementation rate is that the pace of change in technology-driven industries such as electronics is so fast that the companies claim time is insufficient to evaluate each individual invention. Applications are made automatically, "just in case." After a patent has been filed, the Japanese system allows the applicant seven years to decide whetner to have it examined. USPTO Commissioner Donald Quigg called this provision "ridiculous" because it encourages excessive filing, more so in Japan because the cost of a patent application is cheap.

In their haste to be first to file, Japanese companies are lax in checking whether the idea is original. Unlike the US, Japanese law does not require applicants to provide "prior art" demonstrating that the idea is indeed new. Their object in filing is often not to stake out a basic technology, but merely to block their competitors from using an idea that they do not plan to use themselves, a practice known as "defensive patenting."

Japanese companies are increasingly using patents as a crucial part of their business strategy, especially in Europe (where Japanese companies account for 16% of all patents issued) and the US (where they account for 17%). In 1987, the top three companies obtaining US patents were the Japanese giants Canon, Hitachi and Toshiba.

One reason for this rush of applications is a desire by Japanese groups to protect themselves against patent disputes with increasingly litigious US competitors. The US system is based on who is first to invent, rather than, as in the rest of the world, who is first to file for a patent. Another reason is to give them the bargaining power to obtain new technology. Cash is not enough to obtain licences — companies may refuse to sell — and if they do sell, a company without a counter bargining chip can be at a competitive disadvantage when several rivals are licensing the same technology. Thus, building up a patent portfolio is vital for cross-licensing.

Aware that US firms feel disadvantaged, the JPO has begged Japanese companies to be more selective in their filing, but without much success. It has also implemented a US-style "accelerated examination" system for inventions which have the highest probability of being used and a "multiple claim" system to reduce the number of applications. ◼

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ECONOMIES

# Managing China's open door

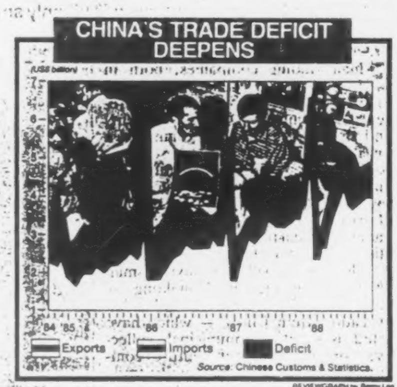
## Trade officials seek way to control a widening trade gap

**By Louise do Rosario**

China is likely to run a US$4-5 billion current-account deficit this year as its phenomenal export growth slows, and a long-supressed wave of imports breaks in the last quarter. The deficit, a turnaround from last year's US$300 million surplus, is moderate enough compared with 1985's US$11.42 billion deficit, and the US$7.03 billion shortfall in 1986, but it highlights worries over whether China can keep exports growing rapidly enough in the long term to meet the rising import bill generated by modernisation.

From 1985-87, Chinese exports grew by an annual average of 35% despite a drop in oil exports from 25% to 10% by value of the total. In addition, the proportion of primary exports fell from 50% to 33%, with manufactured goods exports surging ahead to account for the overall growth.

But China's export drive is still narrowly based on a few geographic and sectoral markets. Hongkong, the US and Japan buy half of China's exports, and textiles, coal, oil and food make up more than half of all exports. The rest comprises a wide range of low-value products such as shoes, toys, handicrafts and tools. To move into higher-value exports will require a level of innovation, flexibility and technology impossible under the present rigid trading system.



Source: Chinese Customs & Statistics.

REVIEWGRAPH by Barry Lee

The Ministry of Foreign Economic Relations and Trade (Mofert) said imports amounted to US$23.9 billion up to 20 September this year (24.6% more than in the same period in 1987), while exports rose only 14.8% to US$28.5 billion. Customs statistics, which are compiled independently and regarded as more accurate than those of Mofert, show imports and exports both growing by 24% in the first nine months, with exports totalling US$32.9 billion and imports US$36.3 billion.

However, the Customs statistics also show imports growing faster than exports since July, with the visible trade deficit widening from US$1.16 billion for the first six months to US$2.26 billion by the third quarter. Offsetting this, tourism income in the first six months amounted to US$1 billion, 26.6% more than last year. Net non-trade earnings are forecast to increase slightly to US$2 billion this year.

The visible trade gap is likely to widen further during the last quarter, as December usually sees imports surge. In December 1986, China imported US$5.54 billion, or 13% of the year's total imports. Last year that figure rose to US$6.56 billion — 15.1% of the year's total.

What, then, has caused the deficit? On the import side, in the first nine months, the major factors were sugar (110% more in volume on a year-to-year basis), timber (71% more), fertilisers (42% more) and pesticides (204% more). A boom in textile processing has also pushed imports of cotton and synthetic fibre by 560% and 54% respectively between January and August.

Wheat imports grew by 27% in the same period. With a disappointing harvest (REVIEW, 3 Nov.), China is expected to import more grain, sugar and vegetable oil soon. But overall, China may have a balance in its agricultural trade since exports of aquatic products, vegetables, pigs and silk grew by 3-17% in the first three quarters.

Export growth this year is again led by textiles, though cotton-made exports have suffered from domestic cotton shortages. In the first nine months, exports of clothing grew by 30%, while those of cotton yarn and cotton fibre dropped by 25% and 12% respectively.

Crude oil exports amounted to 19.79 million tonnes, a 5% increase. With favourable spot oil prices, China imported 1.86 million tonnes of refined oil, 41% more than in the correspond-

## Statement of David S. Guttman

Reviewing a transcript of the testimony of Professor Robert H. Rines of the Franklin Pierce Law Center about why American companies have problems with the Japanese Patent System, I was surprised to learn that my experience and conclusions seriously differ from his on a number of points which I would like to clarify.

I am a practicing L.A. patent attorney specializing in Japanese intellectual property law who speaks and reads Japanese. From 1979–85 I worked in Japan as a U.S. Patent Attorney Consultant at international law and patent offices for about six years. In 1982 in Tokyo I chaired the Licenses, Patents & Trademarks Committee of the American Chamber of Commerce in Japan and have written a number of articles on the patent and trademark laws of Japan.

### 1. IS THE JAPANESE PATENT SYSTEM UNUSUALLY SLOW?

Professor Rines testified that he is not aware of anyone not getting a patent in reasonable time. "In 40 years I have never heard of it, Senator." However, the experience of myself and many others is that the Japanese patent system suffers from unreasonable delay, particularly due to a chronic shortage of patent examiners and a appalling examination backlog. For example, in 1954 the U.S.-Japan Trade Study Group (TSG), a bilateral group of American and Japanese business people in Tokyo reported agreement that:

> Perhaps the greatest problem of Japan's patent system is its slowness. . . . A random check of the patent registrants' index by one American patent specialist in Japan suggests that the typical Japanese patent is issued about six years after the application is filed.[1]

The TSG found that the delay was caused by an insufficient number of patent examiners in the Japanese Patent Office (JPO) and inefficient examination practices. The TSG was skeptical that the understaffing problem would be solved by the JPO's proposed massive building construction and computerization program.

More recently, on November 16, 1989 the American Chamber of Commerce in Japan (ACCJ) adopted a Position Paper on Intellectual Property, warning that:

> Average patent pendency—the period between filing of application and issue of patent—in Japan is one of the longest among developed countries.

Before retiring as Commissioner of Patents, Donald J. Quigg on a number of occasions publicly expressed concern about the JPO's delay in granting patents and its chronic shortage of examiners.[2] Last winter the American Group of the Pacific Industrial Property Association (PIPA), representing about 70 U.S. companies that are heavy users of the Japanese patent system, voiced similar concerns:

> The most serious problem, in our view, is the time required for an application to mature into a patent. It is common for a patent application filed in Japan to be within the office, i.e. under prosecution, for as much as five or six years. This is believed due to the small number of patent examiners working in the Japanese Patent Office and the great number of patent applications filed, by both Japanese and foreign applicants.[3]

In Japan the patent office does not examine a pending application until a separate Request for Examination is submitted with an Examination Fee. In his testimony Professor Rines stated that a major cause of delay is that American applicants do not promptly file Requests for Examination of their Japanese patent applications.

Yet, in my experience even newly filed cases that are accompanied by a Request for Examination are not promptly examined. This is because almost all examiners have a multiyear backlog of cases on which examination has been requested. They tend to examine these backlogged cases primarily in the order of the year in which the application was filed, the date of the Request for Examination being of only secondary importance.

Recently the JPO issued to Texas Instruments Inc. a Japanese patent based on an application so old (1959 priority) that the applicable Japanese patent law did not require a Request for Examination, i.e. examination was automatic. Nevertheless, it took 18 years from the time this particular application, of a type called a "divisional," was filed by T.I. in 1971 until the JPO issued the patent this year.[4] A basic product patent on the integrated circuit (IC), it covers all IC chips made, used, or sold in Japan and is worth about $500 million per year in royalties.

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[1] Progress Report 1984, U.S.-Japan Trade Study Group, September 1984, Chpt. 6, pp. 57–59 (Tokyo, Japan).

[2] "U.S. Urges Japan to Hike Patent Office Staff", Investor's Daily, November 2, 1988, p. 20.

[3] Statement of the Pacific Industrial Property Association, Hearing before the Subcommittee on Foreign Commerce and Tourism of the Committee on Commerce, Science and Transportation, U.S. Senate, First Session on Japanese Patent Policy, Hrg. 101-19, p. 54, February 28, 1989.

As can be seen from the attached Chart 1 analyzing the 18 year examination period, the primary cause of delay was time consumed in ordinary ex parte examination, followed by lengthy periods for a patent office appeal and an opposition procedure.[5] By comparison, the U.S. Patent Office issued the parent U.S. Patent 3,118,743 to Texas Instruments in 1964!

### 2. DOES PATENT DELAY IN JAPAN MATTER TO U.S. COMPANIES?

Professor Rines testified, "I see no difference between the two systems merely because one is a little delayed."

However, I believe these problems have taken their toll. Please refer to Chart 2, which shows the numbers of patent applications American and Japanese companies filed in each other's country in recent years. Such applications are the patent "bargaining chips" or leverage these companies hope to use to enter each other's market. While the interest of Americans in Japan has been increasing rapidly in recent years, there has been little increase in American patent filings in Japan. However, Japanese companies have steadily increased their filings in the U.S., which has a more pro-inventor system.

Next, please refer to Chart 3, which shows the numbers of patents actually issued to American and Japanese companies in each other's country. As you can see, American companies have not been as successful in Japan as the Japanese are here. Moreover, because of the chronic examiner shortage in Japan, there seems to be a falling-off of patents issued to American companies. On the basis of population alone, we would expect U.S. inventors to get twice as many patents in Japan as Japanese inventors get here. In fact, the situation is worse than reversed.

I think these charts are representative of what has been happening to small and medium-sized companies as well as large ones. However, the smaller companies trying to do business in Japan are more greatly affected because their Japanese patent portfolios are so much smaller: these lost or delayed Japanese patent rights are their crown jewels.

### 3. CAN A LIMITED "ACCELERATED EXAMINATION" PROGRAM SOLVE THESE PROBLEMS?

Professor Rines testified that "Any American company that wants to get a Japanese patent on an expedited basis has a way to do it." He then described getting one of his client's cases accepted (not issued) within an incredibly short time, two months.

It is true that the JPO provides for accelerated examination, but only in certain limited cases.[6] First, the applicant must be using or licensing the invention in Japan, or have specific plans to do so within the next six months. Second, the applicant must submit a detailed petition providing prior art, etc. While the JPO does not require a fee for requesting accelerated examination, the Japanese Patent Attorney Association has set a minimum Japanese attorney fee of Y120,000 (about $850). Since the petition must include a statement of prior art, etc., an American applicant will normally also have to pay a substantial fee to his U.S. patent attorney who coordinates these matters and perhaps drafts some of the required statements, claims, etc. And after all this, the JPO reserves the right to reject the Petition if it feels that the case does not warrant accelerated examination.

In Japan, the Filing Fee one pays the JPO for a patent application causes it to be automatically laid open to the applicant's competitors but does not get the case examined. Having fallen hopelessly behind, the JPO demands a separate Request for Examination fee on top of the Filing Fee merely to examine the case. Now, with the Petition for Accelerated Examination, in addition to these two fees, the applicant must further pay a substantial attorney fee for the Petition to procure examination in a reasonable time. Under these circumstances, while the Petition offers an expensive safety valve for urgent cases, it has not been well received or much used by U.S. applicants.

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[4] "Texas Instruments Gets Japanese Patent; Analysts See Sizable Addition to Revenue," Wall Street Journal, November 22, 1989, p. A3.

[5] "TI's IC Patent Finally Registered After 30 Years," Nihon Keizai Shimbun (U.S. ed.), November 26, 1989, p. 13 (in Japanese).

[6] As a courtesy to U.S. applicants, a translation of the Japanese Patent Office's lengthy Regulation for Accelerated Examination was published in the U.S. Patent Gazette on March 25, 1986 at pages 1064 OG 28-36.

### 4. DOES JAPANESE LAYING OPEN OF UNEXAMINED APPLICATIONS BENEFIT THE APPLICANT?

In the U.S. pending applications are secret, but in Japan applications are laid open by publication 18 months from the priority date. In a typical case filed in Japan by a U.S. company, this publication in Japanese of its unexamined application takes place about six months after the U.S. company's application is filed in Japan and is of great benefit to the applicant's Japanese competitors.

Professor Rines testified that in return for the automatic disclosure of his secret application, the applicant receives a right to royalties from those who practice the laid open invention. "In Japan, unlike the United States, the minute the fact that you have filed a patent application is published . . . that starts the time when nobody can infringe that patent without having to pay consequences.

He was referring to Patent Act, Art. 65-3, which provides that an applicant whose application has been laid open can warn anyone who thereafter commercially uses his invention that a *reasonable royalty* may be due the applicant from the time of laying open, if and when the application is finally issued. However, this is a rather limited provisional right which in practice is almost never of practical benefit.

First, the applicant is *not* given any right to halt unauthorized use, only a provisional right to collect a reasonable royalty for it. Second, each "infringer" must generally be given a formal warning, for the sending of which there is an attorney's fee. Third, as a practical matter the patent must issue before one can sue for the royalties. In practice such a warning has little deterrent effect on Japanese infringers and may even encourage them to file a Protest or Opposition which can further delay one's application. Therefore, the "benefits" of this provision are largely ignored by most practitioners as academic. Automatic laying open of applications usually only harms the applicant and benefits his competitors.

### 5. HOW IMPORTANT IS IT THAT AMERICANS BE ABLE TO CORRECT MISTRANSLATIONS?

Professor Rines was skeptical of the need for American applicants to correct the Japanese versions of their applications. "And particularly you say translation trouble. If a company wants to pay money to get the right kinds of engineers, they know how to translate it, and they know how to go in and explain things to their examiners."

However, due to great differences between the English and Japanese languages, a survey of Japanese examiners reported that the applications of American companies are often poorly translated by their Japanese patent attorneys.[7] Translations for filing new applications are usually done under pressure of a priority deadline and may involve breakthroughs in technology for which no standard vocabulary has yet developed in either English or Japanese. Yet serious inadvertent discrepancies in the Japanese translation from the English original cannot be corrected by amendment.

Therefore, I do not agree with Professor Rines that we should ignore this problem or blame American applicants for poor choice of attorneys. The Japanese Patent Law should be amended to allow a filing deadline to be met by submitting an untranslated application in any language and afterwards providing a translation. A foreign applicant who files a Convention application based on a home country application should be liberally permitted to correct errors in the Japanese translation to conform to the original home country application.

### CONCLUSION

I have only touched on a few of the more serious problems American companies are having with the Japanese Patent system. Most applicants are not as fortunate as the clients of Professor Rines in avoiding such pitfalls and would greatly benefit if the Japanese Government voluntarily made its patent system more user friendly. Complacency about the deficiencies of the Japanese patent system will diminish America's great potential for high-tech sales in Japan, leaving Japan's substantial influence on America's patent system and economy highly unbalanced.

Attachment.

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[7] "A Survey of Japanese Examiners' Views of Foreigners' Patent Applications," Patents & Licensing, April 1985, Vol. 15, No. 2, pp. 17–24.

# CHART 1

Japanese Patent 320,275, Registered October 30, 1989
Published for Opposition November 27, 1986, Expires: November 27, 2001

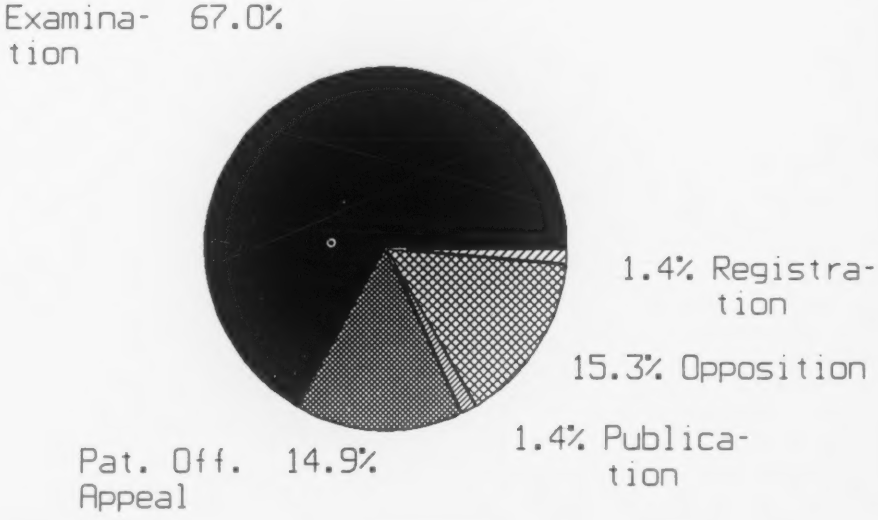
SEMICONDUCTOR DEVICE, Inventor Jack S. Kilby
Applicant: Texas Instruments Inc., Dallas Texas

Japan Patent Appeal 95,001/83 Filed 1983
Japan Divisional Patent Appln. 10,328/71, Filed December 1971
A Division of Japan Div. Pat. Appln. 4,689/64, filed 1964, in turn a Division of Japan Pat. Appln. 3,745/60, filed February 2, 1960

Priority Claim: U.S. Patent Appln. Ser. No. 791,602, Filed February 6, 1959

JAPANESE PATENT 320,275 (11/30/89)

INVENTOR: Jack S. Kilby
Applicant: Texas Instruments Inc.

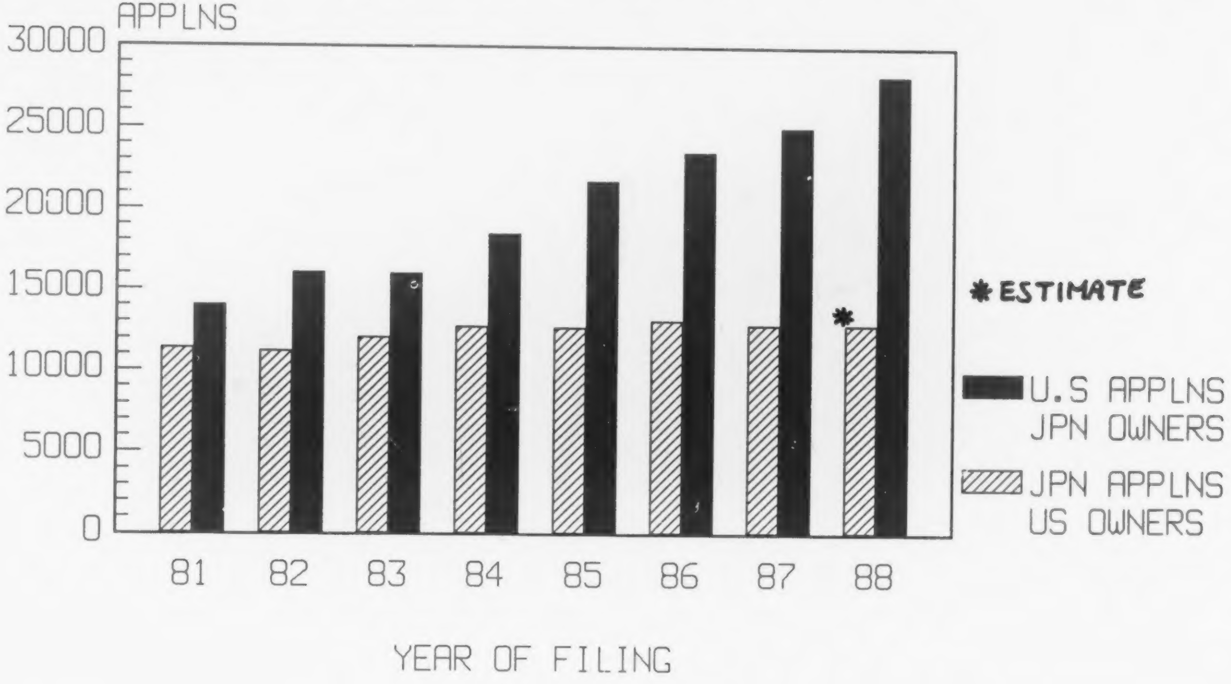


DIVISION APPLICATION PENDING 18 YEARS

## CHART 2

JAPAN AND U.S.A.

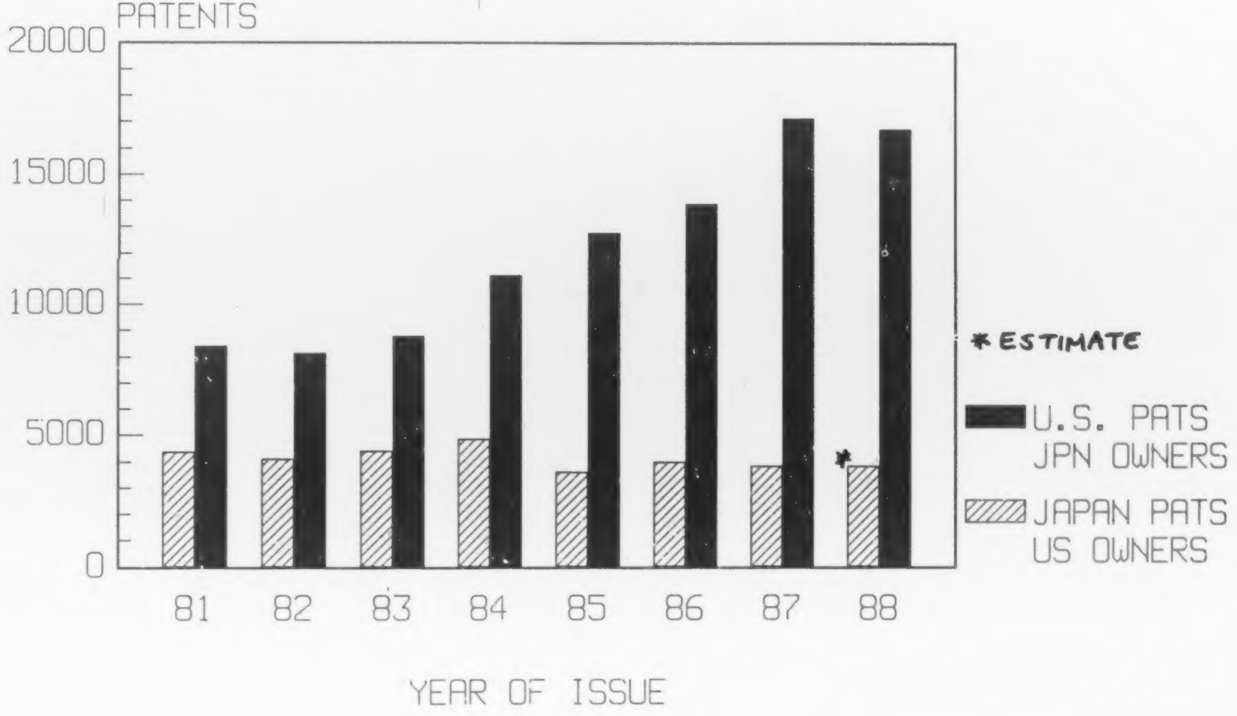
Patent Applications in
Each Other's Country



## CHART 3

JAPAN AND U.S.A.

Patents in Each Other's Country



THE JAPAN ECONOMIC JOURNAL, October 22, 1988 23

**OPINION**

# Cavalier view of patents erodes incentive

By Peter D. Miller

Everyone knows what causes trade imbalances — Japan's productivity, undervalued (until 1986) currency, and export-oriented economic structure, versus the U.S.'s lack of international competitiveness, its consumer-oriented, deficit-ridden economy, and overvalued (until 1986) currency. The remedy was obvious: cheapen the dollar, make imports more expensive and U.S. goods more price-competitive overseas, and the trade deficit would wither away.

It hasn't worked. Clearly the causes of trade imbalances are deeper, and the remedies less obvious, than commonly assumed.

## Transfer of leadership to Japan

The Japanese market is the world's most dynamic, yet exporting to Japan simply isn't worthwhile for many U.S. companies. The key to this mystery is the superior ability of Japanese companies to commercialize new technologies. U.S. companies have an impressive record of inventiveness but have somehow failed to translate it into products, particularly in Japan.

Conventional wisdom attributes U.S. commercialization difficulties to laziness, inattention to customer needs and the arrogance of the scientific priesthood toward mere applications engineering. Whatever merit there may be to these charges, they neglect a far more important factor — the Japanese patent system, which reduces the incentives for foreign companies to commercialize their own inventions in Japan.

## Intellectual property not treated as property

In Japan, intellectual property — patents, trademarks, copyrights and the like — is considered more as a common good than as a right of exclusive possession. This cultural norm operates to disperse the scientific and artistic products of human ingenuity widely throughout Japanese society.

Long delays in issuance of Japanese patents, for example, combined with pre-grant public disclosure of patent applications, make trade secrets available to anyone before the patent is awarded. Patent rights are awarded to the first to register them in Japan, not necessarily to inventors. Disclosure of prior art — a previous invention resembling the claimed invention — is not required, and there is no effective penalty for patent fraud.

A very narrow scope of claim interpretation encourages large numbers of filings based on minor variations. Appeals and adjudication can consume so much time (10 to 15 years in some cases) that the technology becomes obsolete awaiting a final determination as to patentability. Cross-licensing (the exchange of two companies' basic inventions) is officially encouraged and virtually forced on companies unable to obtain timely patent protection of their inventions.

Today's trade imbalances are deeply rooted in patent practices restricting foreign companies' ability to commercialize products in Japan. The exchange-rate "fix" leaves large segments of trade untouched because Japanese companies control the technology, as in VTRs.

In emerging areas of technology such as superconductivity, the pattern is repeating itself: Japanese companies have filed more than 2,000 patent applications in this key technology, many describing products or processes that do not yet exist. If granted, these patents will prevent foreign companies from commercializing working products or processes in Japan.

## Fusion Systems' experience

Innovative U.S. companies opting to compete in Japan on the basis of proprietary technology have attained notable success.

A case in point is Fusion Systems Corp., which was the first company to commercialize high-intensity microwave-driven light sources. In contrast to conventional light sources that use electrodes to energize the lamp, microwave energy activates plasmas that emit light with high intensity, reliability and control. The lamp systems are used for high-speed curing of inks, coatings and adhesives, and for manufacturing graphic arts films and plates, semiconductors and many other products.

Fusion first sold its products in Japan in 1975, and Japanese customers welcomed the new technology.

A large Japanese electronics company that is part of a major industrial group purchased a Fusion product in 1977, reverse-engineered it, and filed more than 200 patent applications on the same technology over the next several years. In one case, the competitor's application for a patent on an electrical circuit contained a slightly altered copy of the drawing in the Fusion instruction manual with no functional difference whatsoever.

In another case, the competitor's application differed from the Fusion prior art only in regard to a function which, though claimed in the patent application, did not work as claimed. In general, the competitor's patent applications were trivial modifications of the basic Fusion design.

Fusion must oppose this flood of patent applications or risk losing its own technology, and with it the Japanese market. The competitor's objective is to obtain through paperwork a patent position in Japan that will force Fusion to cross-license its basic technology.

## A systemic problem

The Japan Patent Office is burdened by a workload consisting of 540,000 applications per year, to be judged by only 856 examiners. If the system has difficulty distinguishing real inventions from copies, this is not the fault of the Patent Office or of its hard-working examiners.

Each examiner has less than half a day to study all the materials submitted in a patent application — clearly an impossible task. Large Japanese companies employing hundreds of patent specialists, who are rewarded for the quantity of their output, exploit the system by flooding the Patent Office with large numbers of applications often containing trivial modifications of previous inventions.

Recent testimony before the U.S. Senate Commerce Committee revealed other cases of abuse of the Japanese patent system.

Corning was told that its patent application would be granted if it specified the percentage of an ingredient in a chemical compound. Shortly thereafter a Japanese competitor was granted a patent on a compound with a one-percentage point difference of the same ingredient. This difference had no effect whatsoever on the performance of the product, but it was sufficient for the Japanese company to avoid infringing the original U.S. technology under Japanese practice.

## Specific improvements needed

Japan has initiated improvements in patent administration by broadening the scope of patent applications, effective since January 1983. In February 1988 the Committee on Problems of Patent Administration called on large companies to carry out thorough self-examination as to patentability before filing applications.

In addition to the Committee's recommendations, the following specific actions would improve the fairness and effectiveness of the Japanese patent system:

- Requiring disclosure of prior art in patent applications.
- Broadening the scope of patent claims and claim interpretation to discourage applications based on trivial variations.
- Effectively penalizing infringement and fraudulent patent filings.
- Keeping applications secret until granted.
- Eliminating pre-grant patent oppositions.
- Providing patent owners with effective means of learning facts surrounding alleged acts of infringement (discovery).
- Providing prompt court appeal of patent office decisions.
- Making injunctive relief available.

Japan, as a leader in technology, should welcome such change, since the basic purpose of any patent system is to foster innovation and contribute to the stock of new technology. In fact, the resulting stimulus could create a renaissance of inventorship in Japan.

Such changes would improve other countries' incentives to export, transfer technology to, and commercialize inventions in Japan. They offer the best (and perhaps the only) prospect for correcting the gross imbalances that now distort world trade.

*Peter D. Miller is representative director, Fusion Japan K.K.*

The Editor
Business Week
1221 Avenue of the Americas
New York, NY 10020

Dear Sir:

I want to rectify one important omission from your "Rethinking Japan" article. It concerns Japanese treatment of U.S. (and I imagine also other foreign) patent applications.

Let me describe my own experience: I was department manager at Westinghouse Research in the 70's, where my group pioneered the so-called "active matrix" flat screen display technology. This technology has now spread across the globe, because it is the only one that can generate a full color TV image comparable to that of the cathode ray tube. Its main practitioners are the large Japanese electronics companies who today use these screens in their pocket TVs, but larger ones will soon appear in laptops and desktop terminals also. However, from 1972 to 1979, Westinghouse was alone in the field, and all its patents, generated in the early to mid-70's are, by virtue of this fact, pioneering patents.

Despite its undisputed primacy, Westinghouse's patent applications - with a solitary exception - were turned down by the Japanese examiners as "obvious" or "already invented in Japan". This was palpably untrue and unfair, but Westinghouse did not contest the decisions, possibly because they did not consider displays to be of great commercial importance to them. [The solitary exception turned out to be the basic patent on the design and construction of a flat liquid crystal color TV screen, which all the Japanese manufacturers today are infringing!]

Recently I started a company, Magnascreen, to exploit some novel concepts on how to build very large area color flat television screens ("wall-TVs"). We have basic patent applications pending in the US Patent Office and we have been considering making applications in other countries, including Japan. The competition to develop such screens is enormous, and the Japanese have formed a large industrial consortium to build them with the technology they "borrowed" from us - a very good reason for my company to be looking for patent protection.

However, our patent counsel has expressed the view that filing in Japan would be a total waste of time and money, and would actually be counterproductive. In his experience the only applications granted by the Japanese examiners are those where a Japanese licensee is involved! In that case, the application "goes through like a breeze"; otherwise, "forget it". In addition, the details of the patent description are widely disseminated before any patent action is taken, thereby allowing competing Japanese companies to copy the designs. In due course the applicant is then informed that his idea was "obvious" or has already been invented in Japan.

In light of this advice, we have decided not to file applications in Japan. The other side of the coin is - much discussed in the media - that an increasing and large proportion of U.S. patents are today held by Japanese companies, who rush in to patent the smallest changes or improvements in their products, and get their applications reviewed and granted in good faith. It seems to me that here is another blatant example of total non-reciprocity in our relations with Japan, and it fits in only too well with a strong "revisionist" view. Or is the above story just more "Japan-bashing"?

T. P. Brody
President and CEO
Magnascreen Corporation

## STATEMENT OF MITSUBISHI ELECTRONICS AMERICA

Dear Mr. Chairman and Members of the Subcommittee: On behalf of the nearly 4,000 U.S. employees of Mitsubishi Electronics America, Inc., and its affiliated companies, I wish to thank you for permitting me to clarify the record of the November 6, 1989 hearing held by the Subcommittee on International Trade regarding the Structural Impediments Initiative. During that hearing your Subcommittee was given an erroneous and one-sided description of a dispute involving Mitsubishi Electric Corporation and Fusion Systems Corporation. This letter will provide your Subcommittee with an accurate and balanced assessment of this matter.

First, on page 2 of his testimony Mr. Spero states that Fusion filed four patents in Japan in 1975 on its "core technology." It is important to view the exact nature of Fusion's "core technology" in the context of overall developments in this area.

Specifically, microwave technology had been known for decades before Fusion was established. A number of companies in the United States, Japan and elsewhere had been active in the microwave area for many years preceding Fusion's development of this "core technology." Various designs for electrodeless lamps using microwave technology have been known since the early 1950's. Mitsubishi has conducted ongoing development in this area since the 1950's. Indeed, Mitsubishi filed an application with the Japanese Patent Office on a microwave system utilizing a discharge lamp in 1966, nine years before Fusion first filed on its "core technology."

Second, Fusion proposes to the Subcommittee that "patent flooding" was found on the basis of Mitsubishi's filing of 300 (actually 257) patent applications in this area of technology with the Japanese Patent Office. What Mr. Spero failed to say was that these applications have been filed over a period of a dozen years, thus averaging about only 20 per year.

Moreover, Mr. Spero did not advise your Subcommittee of one of the important differences in the U.S. and Japanese patent systems, a difference which precludes a proper comparison based solely on the number of applications filed. The U.S. utilizes a multiple claim system wherein an unlimited number of claims can be included in a single patent application. For example, one of Fusion's 1975 U.S. patent applications contained 26 separate claims. In contrast, until recently the Japanese Patent Office utilized a single claim system whereby only one claim was normally permitted per application. Thus, a patent applicant in Japan would until recently have had to file 26 different patent applications to cover the same claims that Fusion covered in a single U.S. application.

Third, Fusion's criticism of Mitsubishi for purchasing and allegedly reverse engineering a Fusion lamp is disingenuous. This criticism is unfounded. All major companies in the U.S. and elsewhere routinely purchase and analyze products on sale in related technical areas. In 1977, Mitsubishi's marketing personnel purchased and analyzed a lamp sold by Fusion. It found the product to be of moderate utility for a small market sector not of interest to Mitsubishi. Rather, Mitsubishi continued its prior research engineering efforts on a lamp: (i) utilizing different technology; (ii) meeting different technological needs; (iii) for a different marketplace. These efforts resulted in the advances patented by Mitsubishi.

Fourth, the analogy offered by Mr. Spero at page 3 of his testimony is inapt. A more accurate approach is to analogize the original invention of microwave transmission of energy to the invention of the internal combustion engine. The Fusion lamp would then be analogous to the application of this original invention in a motorbike, with the Mitsubishi lamp analogous to application of this original invention in an automobile.

Moreover, the patent systems of the United States, Japan and elsewhere expressly contemplate patents on improvements to existing product components. In the United States as well as elsewhere, there are examples of basic products and technologies too numerous to mention on which hundreds and even thousands of patent applications have been filed. As noted above, moreover, those U.S. applications could have contained multiple patent claims, making the sheer number of patents sought even higher.

Fifth, Mr. Spero alleges that Mitsubishi is attempting to coerce Fusion into licensing its technology to Mitsubishi. This is totally false. The cross-licensing proposal here did not originate with Mitsubishi. As Mr. Spero knows, it was Fusion's agent that originally proposed a cross-license arrangement to Mitsubishi. Pursuant to this overture, initial discussions were held between the parties on this issue. However, after Fusion decided that it would attempt to gain a commercial advantage by seeking to apply political pressure, Mitsubishi repeatedly informed Fusion that it has no interest in a license from Fusion.

Finally, Mitsubishi has made substantial efforts to resolve this commercial dispute. The issues here involve somewhat complicated questions of technology and patent law. Mitsubishi has continued to seek a good faith business solution through negotiations with Fusion.

At the same time Mitsubishi has sought the opinions of independent and reputable experts on the issues of Japanese patent law, microwave technology, and business practices. As described in the attached letter of last year to Ambassador Yeutter and in the accompanying exhibits, Mitsubishi went to three experts, two American and one Japanese. Mitsubishi requested that Stanford Research Institute analyze the respective technological developments by Mitsubishi and Fusion. Mitsubishi also requested Mr. John Manning, long time head of IBM's patent licensing program, to examine the history of negotiations between the two companies. Finally, Mitsubishi sought and received a lengthy legal opinion of Yuasa and Hara, the preeminent patent law firm in Japan. The reports of each of these experts support Mitsubishi's position and refute Fusion's allegations from a legal standpoint, an engineering perspective, and a business point of view.

These reports were forwarded last year to former U.S. Trade Representative Clayton Yeutter. A copy of this submission to Ambassador Yeutter is attached. After analysis and review, we understand that Ambassador Yeutter concluded that this issue was a business dispute between two companies to be resolved through normal business techniques. In any event, Ambassador Yeutter took no further action on the matter.

Once again, I deeply appreciate this opportunity to clarify the Subcommittee's record on this issue. I would be glad to respond to any questions that the Subcommittee might have.

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## STATEMENT OF DONALD J. QUIGG

*Falls Church, VA, November 27, 1989.*

Hon. JAY ROCKEFELLER,
*U.S. Senate,*
*Hart Building,*
*Washington, DC.*

Attention: Ira Wolf

Dear Senator Rockefeller:

At the request of your staff, I have reviewed the testimony of Dr. Robert H. Rines, given in the proceedings of a Hearing on Structural Impediments Initiatives, of the Subcommittee on International Trade, Committee on Finance, United States Senate, held on November 7, 1989. I am pleased to respond to that request.

Much of Dr. Rines testimony had to do with performance of the United States Patent and Trademark Office in the period from the 1950s until 1980. I will not consider those comments. The real question as you addressed it to Dr. Rines had to do with the Japanese patent law and how it is administered.

Dr. Rines was correct in stating that it is possible to have an application made special under the Japanese law. However, he used an important qualifier. "Restricted budget!" He stated, "I know some that have very restricted budgets ———. Then you cannot do what I just described to you." (p. 85, ls. 17-20).

The Japanese have about 860 patent examiners. They receive more than 500,000 applications a year. How many applications can they afford to examine on a special basis and still examine more than a small percentage of the total? It is impossible. So what Dr. Rines appears to have been saying is that if you have enough money, you can be one of a select few that can get a patent in a reasonable amount of time. If you don't have the money, you wait your normal turn.

The best figure that I have for the average time the Japanese take for examination of an application is about 3 years. The time that an applicant takes to request examination during the deferred examination period cannot be laid at the feet of the Japanese administration. They do, however, have a provision of their law which permits competitors to delay the issuance of a patent. That is their pre-issue opposition. That can take an additional 2-3 years after the examiner has decided that the invention is patentable.

Dr. Rine argues, p. 75, ls. 20-24, that "unlike the U.S., we do not have to wait for the issuance of patent damages against an infringer." I believe that what he was saying was that after the application is published 18 months after filing, damages can begin to accrue.

One problem with that system is that a person doesn't have the slightest idea what to use to determine whether an infringement is taking place or not. There has been no search or examination. On the other hand, the publication gives a party an opportunity to take any and all of the published information and use it in a research program for the purpose of building a fence around the basic invention before the basic inventor can get his patent. If a patent issues before publication, as in the U.S., the patentee could control that situation.

As for the accrual of damages after publication, that provides no help if the applicant wishes to control the use of his invention. Injunctive relief is not available until the application is published for opposition. The applicant can ask for an injunction at that time, but at very great risk. A substantial bond is required. That is a large risk that most companies do not care to take. Thus, there is in effect a mandatory licensing system which provides the applicant damages (royalties) until the patent issues.

In his testimony, p.83, et seq., Dr. Rines assumes that 1 have concluded that the Japanese are stalling when they reject applications on single issues rather than doing a full search and rejecting on all issues and letting the applicant respond completely at one time. I have made no judgment as to that. My conclusion has simply been that as the practice is carried out, it provides an excellent opportunity for delay.

Although U.S. practice has nothing to do with how the Japanese carry on their operation, I must take exception to Dr. Rines conclusion, p.72, ls. 5-8. The U.S. Patent and Trademark Office figures are averages. Thus, I cannot evaluate his conclusion that in practice it takes between 2.5 and 4 years to get a U.S. patent. However as of October 31, 1989, when I left the Office, the average pendency was 18.3 months. That was a terrific accomplishment by a great group of almost 1600 examiners and their supporting staff. They can be justly proud of their efforts.

Dr. Rines mentioned, p. 72, ls. 16-18, that it took him about 4 years to obtain a patent on an electronic circuit from the U.S. Patent and Trademark Office. He did not mention the time frame of years in which he was operating. However, on October 31, the average pendency of applications in Examining Group 250 (Electronic) was 19.7 months.

I have no information that would cause me to change the conclusions set out in my speech to the Japan-American Society of the State of Washington which you had published in the Congressional Record, S3962, on April 13, 1989.

I hope that these comments will be of some help to you in your efforts to eliminate trade barriers.

Sincerely,

DONALD J. QUIGG.

## DONALD J. QUIGG, ASSISTANT SECRETARY OF PATENTS AND TRADEMARKS

(Japan-America Society of the State of Washington)

### TITLE: U.S./JAPAN INTELLECTUAL PROPERTY RIGHTS AND TRADE POLICY

Thank you for inviting me to be a part of this very fine program, and for the opportunity to address the major role intellectual property plays in the global economy.

We live in an ever increasingly interdependent global community where economic power is the major new force . . . A world created by American creativity and technology . . . A world, however, no longer singularly dominated by American technology.

For the next few minutes, I would ask that you look beyond the confines of the typical intellectual property professional, beyond the world of prosecution and litigation, and beyond the issues of infringement and licensing, and clients, and billings.

Try, if you wills to see just where intellectual property protection fits into the greater scheme of things—how it relates, for example, to technological progress, to the competitiveness of established businesses and the nurturing of new ventures, to the social well-being and the national economy.

You will see that this interrelationship appears more evident than ever before in the 200 years since Thomas Jefferson was examining patent applications. A great deal is riding on the strength of our intellectual property protection system. And I'm not just talking domestically. America's success in international markets will be increasingly dependent upon the establishment of sound and fair systems of protection throughout the world.

In the past few years we have heard much about the ground we have lost in most sectors of world trade. If we are going to reverse that trend, we must create an international intellectual property protection system that will assure a growth of multilateral trade for everyone.

In many cases, the effects of inadequate intellectual property protection on trade are obvious. For example, if a country's patent law does not cover pharmaceutical inventions . . . or the term of protection is very short . . . or the penalty for infringing a patent is very small . . . people can make and sell a pharmaceutical in competition with the inventor's product. The pirate probably can price the pharmaceutical far lower than the inventor can, because the pirate has no research and development costs to recoup. The more product the pirate sells, the less the inventor exports. The effect of Japan's patent system on our exports is not this obvious. Compared with the patent laws of many countries, Japan's patent law is good. Most inventions are patentable, protection extends for 20 years from the date the application for a patent is filed (but no more than 15 years after the patent is granted), and courts can grant both injunctions and damages to a patentee whose patent is infringed. But as Alfred Korzybski has said, "The map is not the territory." To determine whether the law has adverse trade effects, you must look at how- the law actually works.

Japan's law appears to be administered in a way that makes it a formidable, but subtle, trade barrier. An inventor's competitors can use the law to delay, almost indefinitely, the issuance of a patent for the invention. Competitors can use an invention before the patent issues without the inventor's authorization because it is very difficult for the inventor to seek damages and next to impossible to obtain an injunction before he has a patent. In other words, they indirectly have a massive mandatory licensing system. This is particularly bad if the invention has a short life. The Japanese were given a copy of this speech last week and responded that many of my comments about their system are unfair. Their comments with respect to what I have just said are:

(1) The unexamined publication system is well established in the world.

(2) Applicants are provided with the right to demand payment of compensation, for the use of invention disclosed in the publication of unexamined application.

(3) After publication for opposition, inventors can exercise the right to injunction and compensation.

In Japan, however, an unauthorized user can develop improvements in connection with an invention and apply for patents on those improvements, making cross licensing almost a requirement for an inventor who wants to do business in Japan. The threat of compulsory licenses enables Japanese competitors to obtain licenses at favorable rates. They then can produce and sell products that compete with the inventor's in the Japanese market and, often, elsewhere. That means fewer U.S. exports to Japan. Perhaps one means of combatting this is for the U.S. inventor to make sure that all possible uses of the invention are disclosed in the early basic application.

The Japanese response to the latter situation was:

(1) As you know, inventions without inventive steps are not entitled to patent.

(2) Cross licensing is a common form of business transaction in the world. Cross licenses are established after careful evaluation of the patents involved between parties.

(3) Thus cross licensing in Japan need not be disadvantageous to the owners of basic patents. However, as the saying goes, "Justice delayed is justice denied." The opportunity for delay under Japan's law appears to be limitless. A major cause of delay, we believe, is that the Japanese Patent Office is seriously understaffed to handle the volume of application it receives. Last year, approximately 511,000 patent and utility model applications were filed with the Japanese Patent Office contributing to a backlog of approximately 2.5 million (of which 627,000 have requested examination). Their Office has approximately 860 patent examiners to handle those applications. Even if you subtract 50% of the applications which will never be examined, that leaves a huge number of applications per examiner. The Office has announced plans to hire approximately *35* new examiners this year. Some improvement!

In contrast, the U.S. Patent and Trademark Office has approximately 1500 patent examiners and we plan to add 245 more per year over the next several years. Since 1981, we have increased our examiner corps from around 800 to the current level and, as a result, we have been able to reduce the average pendency of patent applications from about 25 months to 19 months. Pendency in Japan is approximately 5 years (a 2 year period before examination is requested and a 3 year period to complete the examination). A major cause of delay in processing applications . . . is *un-*

*derstaffing*. The problem is exacerbated because examiners do not appear to include all of the reasons for the rejection of the application in a single Office action to which the applicant could respond. Instead, examiners appear to reject an application on a piecemeal basis. They will reject an application on a single issue. If the applicant overcomes that rejection, either by convincing the examiner or by appealing the matter to higher authority, the examiner will only then apply another possible reason for rejection. This can go on indefinitely.

The Japanese response was:

(1) Examiners are *supposed* to examine swiftly and appropriately.

(2) Examiners are *supposed* to indicate reasons for rejection as comprehensively as possible.

(3) The JPO provides enough opportunity for response to applicants including cases of insufficient translation.

This does not address what actually takes place.

Competitors of an applicant can use this apparent practice of rejecting an application one reason at a time to their advantage. Once a patent application is published, 18 months after it is filed, outside parties can submit information to show why the published application should be rejected. The information can be submitted in writing, by telephone, or in a personal interview with the examiner. Although the person submitting the information will be notified whether the information is used, the applicant, currently, is not told that any information was supplied. The only way the applicant can learn if its application has been reviewed by anyone or that someone has submitted information about invention's patentability is to review the application file oh a regular basis. That can be very costly for a foreign firm. At a meeting last week of the Working Group on Intellectual Property under the US/Japan Trade Committee, the Japanese Government promised to modify this practice by notifying the applicant and keeping a record in the file of all communications with outside parties.

But, a Japanese competitor can still use the system by reviewing published applications and submitting information to the examiner—a little at a time. If the examiner rejects the application on the basis of one submission, the competitor can wait to see whether the applicant is able to overcome the rejection. If the applicant does overcome the rejection, the competitor can submit more information. If the examiner decides that the invention is patentable, the competitor can use the same information to oppose issuance of the patent. In essence, the competitor gets two bites at the apple all before a patent issues.

Often several competitors will file oppositions if an examiner decides that an invention is patentable. Each opposition may be based on the same or different information. Each competitor has only the cost of a single opposition. The applicant must bear the costs of translating and responding to each opposition. Many applicants, particularly small businesses, either agree to license the competitors at low rates or give up entirely. Either way, the local competitors win.

The Japanese say:

(1) The opposition system is well established all over the world.

(2) Excluding exceptional cases, the number of oppositions fined against an application is normally small. (1.8 on average).

(3) Opposition provides a relatively inexpensive system for the stabilization of patent rights.

Nevertheless, the Japanese examiners also appear to require much narrower claims than would be allowable in the United States. They do this by requiring actual working examples for each claim. In the United States, an applicant must disclose his invention so that one skilled in the art could practice the invention, but we do not require working examples for everything claimed. Obviously, the narrower the claim, the easier it is for someone to "invent around" a patent by making minor modifications.

Competitors do "invent around" significant inventions for which applications are pending. Many times the competitors will fine many of their own applications for small improvements of the basic invention. The applicant finds that it must oppose many of these applications or license those competitors in order to be free to sell its own product in Japan. Once again, maybe a portion of the blame lies with the U.S. attorney who prepared the case.

The Japanese respond by saying: If the applicant discloses his invention in the specification in such a manner that one skilled in the art could practice the invention without difficulty, examiners will not require actual working examples for everything claimed, or require narrowing of claims. This is one of the topics of the Trilateral Conference.

However, if a patent owner refuses to give owners of dependent patents licenses, they can apply to the Japanese Patent Office for a compulsory license. It has never been necessary for the Japanese Patent Office to issue a compulsory license because patent owners agree to licenses rather than have the Government force them to do so. His product then must compete with his licensees' products in Japan and that reduces his sales. The license fees he receives are significantly lower than his profits would have been.

The Japanese say:

- Mr. Quigg's charge is totally unfounded.
- Impartiality and transparency of the proceeding concerning licensing are guaranteed.

Compulsory license is not granted if it would unjustly injure the interests of the owner of basic patent right.

* * * * * * *

As you can see, the Japanese Patent Law acts as a formidable trade barrier for foreign businesses. The U.S. Government has been working multilaterally and bilaterally to eliminate the barriers it creates. Under the auspices of the World Intellectual Property Organization in Geneva, both the United States and Japan are participating in negotiation of a Draft Treaty on the Harmonization of Certain Provisions in Laws for the Protection of Inventions. This effort, which began in 1985, has produced a Draft Treaty of more than 20 Articles, some with rules. If ultimately adopted by Japan the treaty would bring about some significant improvements in Japan's Law—broader claims and a longer "grace" period, for example. The United States would have to change its First-to-Invent practice in favor of First-to-File, as part of a balanced package of improved protection standards internationally. We tested the water with that announcement—and the ripples are still spreading around the world.

Sentiment on that point within the United States seems to range from "never" to "let's dispose of 'First-to-Invent' unilaterally." But in the context of the Geneva meetings, I emphasized that we would give it up *only* if it were part of that "balanced package." I want to explain exactly what I mean by that.

We are looking for equally significant concessions on the part of our partners in such a treaty. Stated in another way, we *expect* to eliminate or modify elements in laws of various countries that tend to tilt the playing field against inventors of other countries. We expect to gain items of interest to the United States . . . items such as an international grace period, a broad definition for patentable subject matter, an adequate patent term, among a number of other things.

Also, we are relying upon *your* advice in pursuing these harmonization discussions. We need and will seek the active participation and advice of the bar, U.S. industry and the Congress in this endeavor. So do not hesitate to become involved, to give us your opinion—or to voice that opinion to your bar representative.

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We also are discussing harmonization of patent laws with Japan and the members of the European Patent Convention. These talks, called "the Trilateral," began as discussions among the European Patent Office, the Japanese Patent Office and U.S. Patent and Trademark Office regarding harmonizing our automation systems.

For example, automation discussions included strategies for sharing electronic system design criteria, patent data standards for storage and retrieval, and so on. Then, the Trilateral sessions started to explore the possibility of harmonization of certain examining practices in the three offices. "Unity of invention" and "inventive step" were the first topics addressed, followed by such additional topics as administrative procedures. For example, those involve specific requirements for claiming priority, timing and scope of amendments, and for filing applications in languages other than the official language of an office. Still later, the Trilateral sessions turned to the subject of scope of patent- coverage, particularly for biotechnology and computer-software-related inventions. They also began to address disclosure requirements. So it was that the Trilateral gradually entered a broad patent law harmonization arena, topic by topic.

Since these discussions have expanded to numerous topics, the 13 member states of the European Patent Convention had to be added because the European Patent Office does not have authority to speak for the member states about issues that would require changes in national law or in the convention. The larger group, called the "Club of 15," met last fall for the first time and decided to coordinate the positions the group will take in the WIPO harmonization discussions as well as to analyze areas in which the laws and practices of the members of the Club of 15 might be harmonized.

During the sixth Trilateral Conference last October, the U.S. Patent and Trademark Office, the Japanese Patent Office, and the European Patent Office finalized and agreed upon a text for harmonizing the unity of invention practice. We now need to obtain authorization to implement this practice.

* * * * * * *

Under the General Agreement on Tariffs and Trade (GATT), we are working with the Japanese and other countries to establish minimum standards of protection for each form of intellectual property, including trade secrets and rights in semiconductor chip mask work lay-out designs. The Japanese have been very helpful in GATT in opposing the effort by certain developing countries to block progress. The negotiations in GATT, however, are not designed to harmonize laws, but to establish minimum levels of protection worldwide and to provide a means for resolving disputes between countries if one believes that another is not fulfilling its obligations.

We also are working with the Japanese bilaterally on those issues that are of concern to us which are not being addressed in WIPO, GATT or the Trilateral. It is in the U.S.—Japan Working Group on Intellectual Property that we are addressing the delays caused by understaffing. We are also negotiating regarding copyright issues involving computer software and sound recordings, trademark issues, trade secret protection, and other matters such as internal and border enforcement of intellectual property rights. The Working Group met most recently last week.

I am hopeful that, over time, these efforts will bear fruit, that the patent laws of the world will be harmonized.

George Bernard Shaw wrote something, often repeated by others, that I believe is appropriate here. "You see things and say, 'Why?', but I dream things that never were, and I say, 'Why not?' " I dream of a day when an inventor, to get protection worldwide for his invention, will be required only to file one patent application in his native language in his own country. The processing of the application will be done once according to standards set internationally by treaty. If the patent is granted, the inventor will merely register his right with the other countries in order to be protected. To make sure that the patents are interpreted uniformly in each country, it would be necessary to have an international court of patent appeals.

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In today's global economy, we must work in partnership with Japan and all the other countries of the world. There is no surer way of impoverishing ourselves than to try to go it alone by not working with the other countries of the world.

By not working with our trading partners, I think of the story of a Sunday school teacher who asked her class, "Who wants to go to heaven?" All the children raised their hands except for one little boy in the back of the room. The teacher, astounded, says, "Charlie, don't you want to go to heaven?" "Yep," he says "but not with this bunch."

As I said at the beginning, we live in an ever increasingly interdependent global community no longer singularly dominated by American technology or trade.

To paraphrase Commissioner Yoshida, at one of our recent meetings, "It appears that we all have basically the same dreams for the future of patents on an international scale. Of course, we cannot be satisfied with leaving them only dreams. We now have the responsibility of striving to contribute—to the development of patent harmonization throughout the world."

I believe our current efforts will help achieve that harmonization and thereby enhance America's success in the international markets.

Thank you very much.

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## STATEMENT OF THE U.S. COUNCIL FOR AN OPEN WORLD ECONOMY

Statement submitted by David J. Steinberg, President, U.S. Council for an Open World Economy, to the Subcommittee on International Trade of the Senate Committee on Finance in hearings on the U.S.-Japan Structural Impediments Initiative. November 4, 1989

(The U.S. Council for an Open World Economy is a private, nonprofit organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The council does not act on behalf of any "special interest.")

In the release announcing these hearings, the Chairman of the Subcommittee on International Trade is quoted as calling the Structural Impediments Initiative (aimed at structural economic impediments obstructing U.S. exports to Japan) "the most important trade negotiation that the U.S. has ever entered into." If the SII may correctly be called a negotiation, it is hardly the most important in U.S. trade history. It is hardly a negotiation at all—that is, it is not a bargaining exercise capable of producing an agreement of much depth and overall substance. The reason is that the Structural Impediments Initiative is itself encumbered by a structural impediment—namely, the absence of a negotiating framework dramatic enough, comprehensive enough, indeed electrifying enough, to energize concessions and commitments as far-reaching as those involving institutional and possibly cultural issues like land policy, the distribution system, the level of savings in contrast to investment, etc., in Japan. The United States would have its own array of trade barriers and other economic policies to reform. The only initiative capable of encompassing all structural impediments, or of making far-reaching inroads even in a limited array of structural impediments, is a free-trade initiative aimed at programming totally free (and, indispensably, totally fair) trade among the contracting parties. (I have outlined such a strategy in previous presentations to the Senate Committee on Finance and other Congressional committees.)

Until a coherent free-trade initiative is undertaken, the current brand of SII talks should be shelved. Re-examining issues that have been on the agenda of U.S.-Japan discussions for many years, the current SII talks (looking toward an interim statement by the American and Japanese conferees next spring and a program of action next summer) are great intellectual fare, but incapable of inducing the results each country expects from the other. Economically far-reaching, culturally impacting, and politically difficult, the reforms necessary from both sides won't happen unless impelled, in fact compelled, by a free-trade compact programming totally free-and-fair trade—involving the United States, Japan, and as many other countries as care to join—in accordance with a realistic timetable. Japan would then be faced with the crucial, perhaps excruciating, choice between (a) staying out, at great cost to its economy in competition with countries that participate, and (b) coming in and making the drastic, productive changes that participation in an authentically free-trade compact would demand.

This free-trade compact (a free trade area under the rules of the General Agreement on Tariffs and Trade) would also impel, in fact compel, a range of U.S. reforms of policy and performance (fiscal, monetary, education, investment, productivity, product quality, etc.) that might otherwise be as resistant to change as are many of Japan's structural impediments on which so much attention has been focused. Such urgently needed changes in the United States have at least as much to do with improving U.S. trade and overall economic relations with Japan as the changes we seek in Japan's structural impediments to U.S. exports.

Is the United States—government, industry, agriculture, labor, the public at large—prepared or preparing for an initiative really capable of dismantling structural impediments to fair and open access to the Japanese market? Far from it. In fact, the SII process may lead to increasingly rancorous relations between the United States and Japan if (as is quite likely) nothing of much substance in lower trade barriers emerges from this exercise. The chairman of the Subcommittee on International Trade has already warned that, if the SII does not succeed on schedule, he plans to push for legislation requiring the Administration to initiate aggressive measures against some of the major Japanese structural barriers—leading supposedly to U.S. retaliatory measures if Japan is not forthcoming with acceptable concessions within a certain period. Retaliation is capable of inducing counter-retaliation in direct or oblique ways.

So, as the Strategic Defense Initiative dwindles into a less ambitious project, say hello to the new arrival in the "initiative" series of government policy planning—the Structural Impediments Initiative. Will our attention be shifting from "Star Wars" to trade wars?

The chairman of the Subcommittee on International Trade stated in the Senate on September 26 that "if free trade is to survive in the United States, the Japanese market must be opened." My rejoinder is that, if the Japanese market is really to be opened as wide as our government feels it should, then free trade must not only "survive in the United States; the United States must, at long last, launch a free-trade strategy worthy of the name. On October 30, the U.S. Trade Representative said: "If the second largest market in the world (Japan) will not open its market, the largest market in the world (the United States) cannot have a trade strategy that includes free trade and open markets." I would rephrase the U.S. Trade Representative's statement, as follows (withholding any question about Japan' s ranking among world markets): If the second largest market in the world (Japan) will not open its market, the largest market in the world (the United States) *must* have a trade strategy that includes free trade and open markets—a free-trade strategy of the kind I have advocated.

We have never had a coherent, definitive, deliberate, explicitly free-trade strategy, and we are not prepared or preparing for one now. Nor, with hardly an exception, is anyone advocating such an initiative.

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## STATEMENT OF THE U.S.-JAPAN BUSINESS COUNCIL

### REPORT OF THE JOINT TASK FORCE ON U.S.-JAPANESE PATENT SYSTEMS

The joint task force from U.S. and Japanese industry met in Washington on October 25 and 26, 1988, pursuant to the joint statement of the 25th Japan-U.S. Business Conference in Tokyo on July 10–12, 1988 to examine their two patent systems and make preliminary recommendations for harmonization. At a hearing conducted by Senator John D. Rockefeller, IV, chairman of the Subcommittee on Foreign Commerce and Tourism of the Committee on Commerce, Science, and Transportation on February 28, 1989, the chairman of the U.S. group testified on behalf of the U.S. group, based on the discussions of the joint task force. The U.S. group also submitted a preliminary report to the Executive Committee prior to its February 1989 meeting in San Francisco.

The following represents an agreed statement of the joint task force.

The task force discussed current problems relating to patent law, patent office rules and practice, and enforcement of patent rights in both the United States and Japan. They also discussed problems relating to recently publicized criticisms of the Japanese patent system. As to allegations raised by particular U.S. companies, the Japanese group took the position that they are not true. In any event, the joint task force did not feel that it could evaluate or offer conclusions concerning disputes between particular companies.

Preliminarily, the group wishes to commend the efforts of their governments and those of other involved countries, as well as the World Intellectual Property Organizations and to endorse current activities in connection with the Uruguay Round of the General Agreement on Tariffs and Trade, to improve intellectual property systems and to harmonize the patent systems of the world. It supports those efforts; its comments should be viewed as consistent with those goals.

It should also be stated that there are many points of harmony that exist between the U.S. and Japanese patent systems and that these similarities are due in part to the constructive collaboration that has existed between the governments, industry, and the bar in the two countries. Our further comments are made against that background.

### THE JAPANESE PATENT SYSTEM

Regarding the Japanese patent system, the joint task force strongly recommends large increases in the staffing of the Japanese Patent Office, and other efforts, in order to greatly lessen the backlog of pending patent applications and the time of pendency of such applications in the Patent Office.

The task force recognizes that the relatively large number of Japanese patent applications filed in Japan by Japanese companies is due in large part to the Japanese single patent claim practice which existed for many years. The practice was changed recently and the task force supports efforts to encourage rapid adoption of the new multiple claim practice.

Additionally, the U.S. group recommended that (1) the Japanese Patent Office permit patent applications to be filed in foreign languages, as is now possible in the U.S. Patent and Trademark Office, subject to timely submission of acceptable translations, (2) correction of translation errors be permitted, based on consistency with the priority document, and (3) and (4) the Japanese systems of lengthy (seven-year) deferred examination and pre-grant opposition be eliminated in order to lessen the frequently long period of time before a patent is granted and effectively usable to maintain exclusivity.

The Japanese group felt that the question of filing in a foreign language should be dealt with in a multilateral forum. They believed that there are difficulties in using a foreign language text as a source document for permitting corrections of translation errors. They stated that any alleged disadvantages in the deferred examination and pre-grant opposition systems would be lessened by ensuring an efficient, speedy, and early examination of patent applications and efficient and speedy conduct of oppositions. They pointed out that the deferred examination serves to lessen the workload at the Japanese Patent Office and thereby shortens pendency time. The Japanese group was of the opinion that the opposition system prevents patents of questionable validity from being granted and enforced.

The U.S. group noted that many deferred applications are eventually examined and the problem of examination is thus merely put off to the future. The Americans believed the answer lay in a prompt, effective patent office examination. They believed that with pregrant oppositions and invalidity trials, a patent can be effectively tied up in challenges for all or most of its lifetime. While they recognized that these recommended changes would not solve all problems with the Japanese patent system, their total impact would be beneficial.

The joint task force also considered issues relating to Japanese patent litigation practice, with the U.S. group expressing interest in broader interpretation of patents in the courts, faster handling of litigation, and greater ability to obtain preliminary injunctions. The Japanese group pointed out that the average litigated case is disposed of in less than four years, that courts have recently interpreted patents more broadly than in the past, and that preliminary injunctions have been granted in a significant percentage of cases. The U.S. group welcomed and encouraged these trends, although they had not themselves experienced the changes.

## THE U.S. PATENT SYSTEM

Regarding U.S. patent practice, the joint task force recommends (1) modification or elimination of interference practice if a suitable package of changes can be agreed upon in harmonization talks being held under the auspices of WIPO, (2) modification or elimination of 35 U.S.C. 104 and the so-called Hilmer doctrine, subject to the WIPO harmonization talks, (3) some expansion of the right of third parties to participate in reexamination practice, beyond the current procedure now under review in the Patent and Trademark Office, and (4) change of patent term to begin with date of patent filing rather than date of patent grant in order to avoid unduly extended patent terms resulting from protracted preissuance proceedings. The group also supports the current trend toward a more reasonable and comprehensible application of the duty of disclosure.

The Japanese group expressed concern that the U.S. Patent and Trademark Office has granted some patents that should have been rejected and that, in a time of stronger enforcement of patents, third parties could be and have been harassed by such patents. The U.S. group is also committed to issuance of quality patents. It commented that the overall performance of the U.S. Patent and Trademark Office was generally of a high quality and that the strengthening of the patent system was healthy and important for innovation.

## GENERAL COMMENTS

In general, the joint task force (1) recommends that applicants submit to patent offices the closest prior art known to them in order to ensure that only valid patents are granted, (2) agrees that patent applications should only be filed on inventions made by the applicants which have not been copied from others and which are not known to be unpatentable, (3) supports adoption of a uniform standard for ensuring unity of invention, (4) opposes any kind of administrative interference or influence on the patent examination or adjudicative process and disapproves of collusive oppositions or reexaminations intended to harass or overwhelm patent applicants, (5) supports current trends to permit grant of broader patents, when properly supported by disclosure, and to interpret patents to provide protection in accordance with the importance of the inventive contribution embodied in the patent, even if beyond the literal scope of the patent claims and specific embodiments disclosed, (6) urges adoption of a uniform grace period, and (7) supports maintenance of a uniform and high standard of patentability in the U.S. and Japanese patent offices.

It is hoped that the above-noted views of the joint task force will contribute to the improvement and harmonization of the U.S. and Japanese patent systems and to mutual understanding between industry and government in both countries. It believes that the meetings were conducted in a spirit of professionalism and good will. The task force will be pleased to meet again if circumstances indicate the desirability of doing so.

ALAN D. LOURIE.
S. UCHIHARA, *Chairmen, April 19, 1989.*

WP 6-23-89 G1

# Hidden Wall: A Native Son Battles Japan's Trade Barriers

## *Ryusuke Hasegawa's Frustrating 4 Years*

By Fred Hiatt
Washington Post Foreign Service

TOKYO—It seems, at first, a familiar story. American businessman comes to Japan with great hopes, works his heart out and, four years later, retreats to New Jersey, a beaten man.

Ryusuke Hasegawa had heard such tales, but thought he was immune. Hasegawa, a naturalized American, was born in Japan 49 years ago, attended college here and didn't leave until he was 24, Japanese master's degree in hand. No one could complain that he didn't know the language or customs.

He came, moreover, with a high-tech product to sell, a $12 billion corporation, Allied-Signal Inc., to back him up and a partnership with some blue-chip Japanese companies.

Yet this month Hasegawa, like hundreds of less-prepared businessmen before him, will indeed retreat, somewhat bitterly, to New Jersey. He has spent much of his time defending Allied's invention against patent challenges by Japanese competitors and meeting and drinking with potential customers who never seemed quite ready to buy. At the same time, the Japanese government was funding research to catch and surpass Allied-Signal.

"I feel bad for American companies," Hasegawa said in a recent interview. "We do a lot of basic research, and when we are about to be successful, a Japanese company comes in and gets the business."

Hasegawa's disappointment may help explain one side of the $50 billion U.S. trade deficit with Japan that is frustrating policymakers and inflaming anger on both sides of the Pacific. Like many foreigners before him, Hasegawa ran into invisible cultural trade barriers, a Japanese instinct, official and unofficial, to protect its industry from foreign competition and the willingness of cash-rich Japanese firms to invest hugely in research rather than cede any ground to competitors.

And while Allied's failure so far cannot be blamed solely on Japan, the company appears to have avoided many pitfalls to which Japanese often attribute American business failures here, such as lack of cultural and linguistic understanding or an expectation of instant results in this difficult market.

With Hasegawa's departure, Allied-Signal will not give up its efforts to sell the amorphous metal products it developed in its New Jersey laboratory. Hasegawa, who will visit frequently, still thinks Allied's joint venture here will succeed.

BY [illegible] FOR THE WASHINGTON POST

Ryusuke Hasegawa, vice president of Nippon Amorphous Metals, in his office.

Moreover, Allied-Signal has other subsidiaries, joint ventures and affiliates, some of which have been here more than 50 years, together generating sales of $700 million a year.

Altogether, U.S. exports to Japan totaled $42 billion in 1988, up from $31.5 billion the previous year.

But Hasegawa, in a recent interview, acknowledged that he is frustrated by the meager fruits of his four years' labor. Nippon Amorphous Metals Co. Ltd., as the joint venture between Allied and the Mitsui group is called, is still earning only $2 million a year, half its operating expenses.

"I thought, 'This is ridiculous. I speak the language, I understand the customs, this isn't going to happen to me,' " Hasegawa said. "And then things didn't go as I expected.

"The Japanese like harmony," he continued. "You say, 'Buy ours, it's cheaper,' and they won't. And you say, 'Why not?' And they say, 'Because we're happy. You're destroying our harmony. Everything was harmonious until you came along.'

"We buy Japanese cars because

See HASEGAWA, G10, Col. 1

# A Native Son's Battle With Japanese Barriers

HASEGAWA, From G1

they're good. Well, we have a high-tech product that is good—and they're not listening to us."

Hasegawa wears the navy suit of a businessman but, with his shy manner and hair falling just above his eyes, has the look of a scientist. In fact, he is both, an engineering PhD from the California Institute of Technology as well as vice president of Nippon Amorphous Metals Co.

He left Japan in the 1960s to get the best science education possible. Like many Japanese scientists—including Susumu Tonegawa, Japan's Nobel laureate who did his prize-winning research in Switzerland and now works at the Massachusetts Institute of Technology—Hasegawa was attracted by an openness in U.S. labs that encouraged creative thinking.

"In Japan, you can't speak your mind," he said. "The professor is all-powerful. You can do improvement over certain technology, but if you want to do something drastically different, it is very difficult."

So Hasegawa chose to stay, working first for International Business Machines Corp. and, for the past 14 years, at Allied-Signal. There, in the 1970s, he was part of a laboratory team, along with Indian-born David Marasimhan, that discovered how to make "amorphous metals."

Such metals are heated until molten, and then suddenly cooled—from 1,000 degrees centigrade to room temperature in a millisecond—so that they retain the crystal structure of a liquid. With the process Allied developed, components of computers and other electronics can be made smaller, and electric transformers in utility poles can be made more energy-efficient.

"Japan has no oil," Hasegawa said, so he believed utilities here would welcome the product. Enough utility-pole transformers are replaced here annually to offer a $65 million market, he said. Several utilities in the United States, including Virginia Power Co., have begun replacing old transformers manufactured by Westinghouse or General Electric Co. with those that use Allied's amorphous metal.

They are more expensive to buy than traditional steel transformers, according to the Electric Power Research Institute, but save money in the long run by minimizing energy loss.

But after four years, Hasegawa was unable to interest a single electric company here in Allied's product. The utilities never said no, but always they needed more time, more tests, more study. Allied's efforts challenged two of Japan's most powerful corporations, Nippon Steel and Kawasaki Steel, which make the silicon steel now used in transformers. Hasegawa said giant firms use their muscle to keep competitors out, threatening to cut off supplies if the system is disrupted.

Hasegawa noted that Allied's Japanese patents on amorphous metals expire in the mid-1990s. "The utilities say they're interested, but not now," he said. "They may be waiting for our patents to expire."

Indeed, a Nippon Steel spokesman said his company is developing its own capability to make amorphous metal, aided by more than $11 million from the government's New Technology Development Corp. since 1981. But the spokesman, who asked not to be named, denied that Nippon Steel pressured utilities to stay away from Allied. "We are just proceeding with our own effort," he said.

A spokesman for Tokyo Electric Power Co. declined to comment.

Meanwhile, another corporate giant, Hitachi Metals Co., challenged Allied's patents and filed its own. The time spent in patent court troubled Hasegawa most, since he believes that Hitachi changed Allied's process slightly and claimed it as a new invention.

"If you invent a knife of a different shape, in Japan you can patent that," Hasegawa said. "In the United States, it's still a knife." A Hitachi official disagreed, arguing that Hitachi independently invented a way to make amorphous metal. Hitachi has won one legal battle against Allied, allowing it to sell some products in the United States, while most Japanese battles remain unresolved.

Whatever the merits of this case, Allied's complaints are not unusual, according to a U.S. Commerce Department official.

"Many practitioners in the United States believe that Japanese courts have been less than friendly in providing a fair measure of protection to patented inventions," Michael Kirk, assistant commissioner for external affairs, told a Senate subcommittee in February.

In all, Hasegawa said, he came to feel that Japanese companies regard his venture with suspicion because it is foreign, despite his Japanese partners and his own Japanese heritage.

"The Japanese have this strange custom," he said. "They have to do everything themselves. Why do they have to make scotch whiskey? Why do they have to make wine? They don't even have a grape suited to wine.

"I was born in Japan, I was brought up in Japan, but I still don't understand it."

# The Japanese Patent System: A Non-Tariff Barrier to Foreign Businesses?

Arthur WINEBERG[*]

Japan has been accused even on the floor of the United States senate of using its patent system to advance its own industries at the expense of foreign enterprises.[1] It is true, as shown below, that the Japanese have been able to use the patent system for their own competitive advantage, by creating formidable and sometimes unassailable obstacles to foreigners seeking the same patent protection in Japan they receive elsewhere. But it is also clear that the objective of Japan's patent system does not include discrimination against foreigners. Enjoying patent protection in Japan requires an understanding of the Japanese way of viewing patents and business affiliations. The fact that foreigners find it more difficult to receive patents in Japan is due to their lack of understanding of the Japanese way. This article explores the Japanese patent system to show how foreigners must adapt themselves to the system, for the Japanese system does not conform to the foreign way.

Last year in the United States, the Japanese were awarded almost 20 per cent of the patents issued;[2] that is more in percentage terms than all foreigners were awarded in Japan. In Japan foreigners receive only about 17 per cent of the patents issued, and Americans only 7 per cent.[3] The other developed countries generally award foreigners more than 40 per cent of the patents they issue. For example, in the United States, foreigners received about 45 per cent of all patents issued in 1986.

United States companies claim that for inventions for which they receive United States patents, they do not experience commensurate success in getting patents in Japan.[4] Tales of foreigners' frustrations over difficulties in protecting their inventions in Japan are part of the oral tradition of doing business in Japan. The statistical evidence available confirms that foreigners are not given the same protection for their inventions in Japan as the Japanese obtain in Japan and in foreign countries.

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[*] Attorney, Director of the Office of Unfair Import Investigations, International Trade Commission. The views expressed here are those of the author and do not reflect the opinion of the Commission, or any of its Commissioners.

All references to "Article" concern the Tokkyoho (Patent Law) No. 121, 1959, as amended Law 41, 1985.

[1] See e.g. Senator D'Amato, *The Danger from Japan*, Congressional Record—Senate, S12805 (October 7, 1985).

[2] Annual Report Fiscal year '86, Commissioner of Patents and Trademarks, Washington, D.C. 1987, Tables 9, 14, 16. See also The Washington Post, 17 March, 1987, C-2.

[3] Japan Statistical Yearbook, 1985, p.672.

[4] See e.g. Testimony of Jonathan W. Hinton, Vice President and General Manager, SOHIO Engineering Materials Company, Before the Subcommittee on Economic Goals and Intergovernment Policy of the Joint Economic Committee on the Case of Japan: Barriers to U.S. Exports, 22 August, 1985.

Current data about the success of patent applications involving the same claim of invention in the United States and Japan suggest that United States companies fare far worse in Japan than in the United States. In the last three years United States industries have accused Japanese companies before the International Trade Commission (I.T.C.) of infringing 28 U.S. patents. Of these, United States companies had filed corresponding patent applications in Japan in 16 instances, of which only three had matured into patents. The experience of United States companies in other countries is better: of the 75 U.S. patents which foreign companies (non-Japanese) were accused of infringing before the I.T.C., corresponding patent applications were filed in the domicile of the foreign company in 34 instances, and patents awarded in 17 instances. It would appear that American companies have much more difficulty securing patent rights in Japan than Japanese companies experience in the United States.

These data and anecdotal evidence are particularly worrying, because an examination of the principal provisions of the Japanese patent laws does not reveal anything particularly different or discriminatory. Japan has patterned its patent law on that of the Federal Republic of Germany. In addition, many other countries give priority to the first to file, disclose the contents of the patent applications within a certain time of filing (laid open applications), examine applications only upon request (deferred examination), and allow the granting of the patent to be opposed (public opposition to patent applications). Nonetheless, the costs and difficulties which confront foreigners trying to obtain patent protection in Japan appear to be greater than those in other developed countries.

This article begins with an analysis of the Japanese laws governing patents. It focuses on how the Japanese patent laws are peculiarly suited to Japanese culture, and on the resulting problems foreigners must confront when applying for patents in Japan. A modest proposal for dealing with the Japanese patent laws is offered at the end of this article.

The Japanese view of patents in the economy and in society is very different from ours. They have drawn up patent rules that reflect a view of patents as a competitive weapon. The Japanese recognize the competitive advantages the owner of intellectual property has. While the western nations think of patents as just another form of property to be exchanged in the marketplace, in the hands of the Japanese patents become blunt weapons to be used to gain competitive advantage.

As a society, the Japanese view inventions more as a public, and less as a private, good than we do in the United States. As a result, in Japan cross-licensing is more prevalent, and patents are seen more as a means to reward inventions and less as a right to exclude others from use than in the United States.

The Japanese patent system, by its design and operation, reflects two other basic Japanese values. In addition to treating trade as a "net sum" game, the Japanese make every effort to avoid direct social confrontation and litigation. The patent application system is full of opportunities to file opposition. But once the patent is issued, the procedure for contesting validity or enjoining infringement is neither simple nor expedient. The delays and uncertainties created in dealing with opposition and infringement litigation re-enforce the Japanese cultural proclivity for cross-licensing each other. Moreover, the Japanese have a village or insular mentality—they are more willing to share and license their intellectual property with other Japanese.

## Scope of Patentability

The Japanese essentially use the same standards as the United States for patentability—novel, useful and non-obvious. (Article 49) A patent will not be registered when: the invention was publicly known in Japan or publicly used in Japan prior to the filing of the patent application, described in a publication distributed in Japan or elsewhere prior to filing, or was obvious to one of ordinary skill in the art (Article 29); the invention relates to unpatentable subject matter (Article 32); the right to obtain a patent is co-owned (Article 37); another person has filed an application earlier than the one under examination (Article 39); the detailed explanation of the invention in the specifications is insufficient for a person skilled in the field to which the invention belongs to understand it, or matters indispensable for the construction of the invention are not specifically described in the claim (Article 34(4) and (5)); the application covers more than one invention and does not fall under Article 38; or the applicant is neither the inventor nor his successor in title to the invention. (Article 49(iv)).

If none of these defects exists and the invention is "industrially applicable", the inventor is eligible for a patent. The only inventions not patentable in Japan are: inventions manufactured by the transformation of the atom[5] and those liable to contravene public order, morality or public health. (Article 32)

## Persons Entitled to File an Application

Japanese citizens can file patent applications, but an inventor who is not a Japanese citizen cannot file his own application. He must have a patent administrator, who is a citizen of Japan, file the application on his behalf. (Article 8) Even with a patent administrtor, a person who is not a Japanese subject may not be allowed to file for patent protection in Japan unless the country of which he is a citizen accords Japanese nationals a like privilege, or is a party to a treaty with Japan providing for reciprocity or national treatment in the enjoyment of patent rights. (Article 25)

## Requirements of an Application

Like almost all countries except the United States, Japan follows a first-to-file system of patenting. (Article 39)[6] If two or more patent applications are filed for the same invention, only the first can obtain a patent on the invention. If a patent application is not promptly prepared and filed for each claimed invention, someone else may discover the same invention later, file a patent and acquire exclusive rights. *Moreover, even if the inventor files first, anyone who at the time he files has made the invention independently or has been commercially working the invention in Japan shall have a non-exclusive license.* (Article 79) Consequently, a Japanese inventor is eager to file so he can assert priority. The Japanese throughout the research and invention process constantly evaluate not only whether the results are patentable, but also when the process is far enough advanced to file a patent application.

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[5] The United States has a similar exception, see 42 U.S.C. 2181.

In fact, the patent laws encourage the Japanese to file a patent application as early as possible. Japan has no requirement that the applicant must show he has reduced the invention to practice.[7] In addition, for the first 15 months after the application is filed, the applicant is usually allowed to modify his application freely. (Article 17) Thereby, in his eagerness for priority, a Japanese very often files his patent application before the invention is even developed to a point where the inventor can describe it with the requisite specificity. But since an application can be amended freely in the first 15 months (Article 17) and thereafter for numerous reasons without losing priority (see Articles 17–7, 17–3),[8] the applicant is able to secure priority by early filing and as the continuing research allows, subsequent perfection of the application through amendment. To those such as U.S. inventors who file only after the invention is conceived and reduced to practice, priority may be lost, at least in Japan.

If two or more applications relating to the same invention are filed on the same date, the applicants must agree among themselves as to who will obtain a patent for the invention. If they cannot agree, none of them will obtain it. (Article 39(2)) This system does not encourage confrontation. On the contrary, the incentive is clear: reach an agreement voluntarily or there will be no patent for anybody. This is one example of how the Japanese system does not closely associate property rights with the power to exclude others. It is to the applicants' joint advantage and in the individual interest of each to agree to name one as the inventor. He immediately in consideration, grants the other applicants a royalty-free license with the right to license related patents.

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[6] The United States, Canada and the Philippines are the only countries whose patent laws do not determine priority in accordance with the first-to-file principle. Rosenberg, *Patent Law Fundamentals*, p.10-3.

[7] An application, when filed at the Patent Office, must contain: the name and domicile or residence of the applicant; the date of filing; the title of the invention; and name and domicile or residence of the inventor. The application must also be accompanied by the specification, which may include drawings where necessary, and will include: the title of the invention, a brief explanation of any drawings, a detailed explanation of the invention, and the scope of the claim or claims. (Article 36) The required "detailed explanation of the invention" in the specification must contain a statement of the purpose, composition, and effect of the invention in such a way that any person having ordinary knowledge in the technical field to which the invention belongs may easily work the invention. (Article 36(4)) In contrast to U.S. patent law, the application need not contain an enabling disclosure or have been reduced to practice.

[8] But if an amendment is filed after 15 months of priority date, which would change the gist of the application, it cannot be accepted. Article 53(1).

## LAID OPEN APPLICATIONS AND EXAMINATION

The content of the application is "laid open" to the public 18 months after it is filed[9] unless it has already been published, which is unusual. (Article 65–2) Laying open for public inspection is done by publishing the application in the Patent Gazette, including specifications and drawings. (Article 65–2) The invention is therefore no longer secret.

Laying open the application has the effect of promoting licensing of the invention. By laying the application open to the public, the invention becomes known to the public, so anyone can use it commercially or for research and development. After the application is laid open, the applicant may require any person who commercially worked the invention before publication, but after being warned of the application and its content, to pay what would be a reasonable royalty rate if there were a patent. (Article 65–3(1)) This right to require compensation is not exercisable until after a second publication, i.e. publication for opposition. (Article 65–3(2)). While it is true that a person who uses the invention commercially becomes liable for royalty payments beginning on the date the application is laid open, the applicant cannot collect payment until the patent is issued. If a person limits his use of the invention to research and development, he incurs no liability. In fact, if his research and development succeeds, and he improves the invention described in the patent application, and files an application on the improvement, he will earn the right to use the invention commercially even after it is patented. Specifically, in order to use his improvement he has to use the invention, then statute grants him the right (with payment of a reasonable royalty) to the invention. By creating conditions favorable to improving an invention by making it public early, and by imposing compulsory licensing, the laying open of the application creates a potential limitation to the patent right of exclusivity.

Laying open the application is the beginning of determining the patentability of the invention. Before a patent is issued, the application must first be subject to examination. Examination is only upon request, and any person may request examination.[10] (Articles 48–2 and 48–3(1)) When the requestor is a person other than the applicant, the latter is notified. (Article 48–4) If no one requests examination, seven years after the date of filing, the application is deemed to be withdrawn. (Article 48–3(1))[11]

The request for examination initiates the examination process. An examiner considers the application and if he does not find any reason for refusal, he orders the pending patent application published for opposition. (Article 52) The substantive examination to determine whether the claimed invention is patentable occurs only after publication for opposition. (Article 51) Those persons filing opposition provide the patent examiners with arguments and grounds against granting the patent.

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[9] As a signatory to the Paris Convention (Paris Convention for the Protection of Industrial Property, Mr. 27, 1883, 21 U.S.T. 1629, T.I.A.S. No. 6923; 192L.N.T.S.4459), Japan will recognize the earliest foreign application as the priority filing date for the Japanese patent application, as long as the Japanese application was filed within 12 months of the earliest foreign application and the foreign application was filed in one of some 80 other countries signatory to the Paris Convention. If priority is based on a foreign application, the 18-month period before publication is computed from the filing date of the foreign application. Thus, publication can be as early as six months after filing of the application in Japan.

[10] The fee for examination is not insignificant: 33,000 yen per case plus 5,300 yen per invention.

[11] The seven year deadline is waived if there is a division of the patent application, a conversion of the application to a utility model, or a new application upon declination of amendment—but the request must then be made within 30 days of the originating action. Article 48–3(2).

Many applications are filed defensively and examination is never requested. The applicant may not believe the claim merits a patent, or the expense of examination, but by filing, he preempts anyone else from receiving a patent for the invention and can oppose another application on the grounds it lacks novelty.[12] In these instances a request for examination is rarely made, as the filing serves the entire purpose of declaring priority.

Upon publication for opposition, the law also grants the applicant the exclusive right to exploit commercially the invention claimed in the application. (Article 52(4)) The applicant can also sue and thereby exercise the right which was created and given him at first publication to receive compensation from those having used his invention. (Article 62–3) However, that right is less than it first appears. It is created contingently, but enforcement is delayed until it is established that the patent right will not be defeated at the patent office. The patent may never be issued, and if it is not, the right is deemed never to have arisen. If, upon an applicant's request, a court enjoins someone from commercially exploiting the invention, and then the patent is not registered, the applicant becomes liable to indemnify any damage caused to the enjoined party. (Articles 52(3) and 52(4)) Thus, until the patent is registered and all invalidation proceedings are complete, courts do not enforce the applicant's exclusive right to exploit the invention commercially. In fact, regarding the statute's provisional right, a defendant is expressly given the right to request suspension of the court suit to enforce the provisional right.[13] This inchoate right of the patentee becomes, when the patent is issued, the right to recover damages for use of the invention from the publication of the application. In effect, publication creates a contingent liability on anyone, other than the applicant and his licensees, who commercially works the invention. In practice, the creation of contingent liability provides an incentive to those wanting to use the invention to negotiate a license with the applicant.

The applicant also has incentives to license. If the invention is commercially valuable, others will want to use it. However, if a license to protect them from suit by the patent owner is not forthcoming on reasonable terms, those who want to use the invention may file opposition to the patent application, increasing the risk the patent will never be registered, or will be registered with much narrower claims, and certainly increasing the cost of prosecuting the patent.

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[12] In the first-to-file system in Japan, the first inventor who files is eligible for a patent, even if others have discovered the invention earlier, as long as the first applicant independently invented the claimed invention. Of course, if the earlier inventor operates the invention in public prior to the date of the application, neither receives a patent for the invention.

[13] Article 52–2. In actions for infringement and invalidation, the court at its own initiative may suspend the court proceeding pending trial at the Patent Office. (Articles 65 and 168) Only with respect to actions to enforce provisional rights may the defendant initiate the suspension of the court proceedings pending administrative action of the Patent Office.

An essential part of the examination process is the filing of opposition. Within two months of publication for opposition, any person has the right to oppose an application. All an opponent needs to do is file a written opposition stating the grounds for it together with any supporting evidence. (Article 55) The Japanese Patent Office relies upon such persons to show why a patent should not be issued, and the office provides them with a number of opportunities to oppose the application.

The oppositions are given to the applicant along with "an adequate time limit" ("adequate" being determined by the Patent Office) to submit a written reply. (Article 56) As part of his reply, the applicant may amend the wording of his claims, or narrow, or completely withdraw certain claims in order to put in question the grounds for opposition. (Article 64) The applicant also may file a written response to the opposition without filing an amendment. (Article 57).

After ruling in writing on any initial opposition, the examiner must also decide whether or not a patent is to be granted for the application. (Articles 58, 60)

## TRIAL AT THE PATENT OFFICE

The examiner's decision is not final. The dissatisfied party, whether applicant or opponent, or anyone else, can appeal against an examiner's decision by a request, in writing, for a trial. (Article 121, 123, 131)

If the examiner decides to refuse the application, within 30 days of the rejection the applicant can demand a trial before the Trial Board of the Patent Office. (Article 121) As part of this appeal, he is again given the opportunity to amend the claim to take into account the weaknesses in the application as found by the examiner. (Articles 17–3, 50)

If the examiner issues the patent, any person may request a trial for its invalidation. (Article 123) This can be requested at any time. In fact, the only way of challenging the validity of a patent is by trial before the Patent Office. Thus, anyone sued for infringement will probably request an invalidation trial. Thus, even someone who did not oppose the patent initially, or someone whose opposition was unsuccessful before the examiner, can demand a trial for invalidation of the patent on the same or different grounds from those put before the examiner. (Article 123) Any party who demands trial for invalidation may also ask to intervene in the trial for invalidation. (Article 148)

A decision to invalidate a patent, when it becomes conclusive, means that the patent is considered never to have existed. (Article 125) For this reason, trials for infringement are usually suspended pending the outcome of an invalidation trial. (see Article 168 (2))

The trial for invalidation is conducted by a body of three or five trial examiners appointed by the President of the Patent Office.[14] (Articles 136, 137) There is no pretrial discovery by the parties, although a party may request the preserving of evidence. (Article 150) The trial may be by oral examination or examination of documents. (Article 145) The decision is by majority vote, in writing, and must provide, *inter alia,* the conclusion and the reasons therefor. (Articles 136, 157)

The trial decision at the Patent Office is not necessarily final either. The losing party may demand a retrial. (Article 171) The time limit for this is relatively liberal. There is a 30-day rule for the party demanding retrial, but it has many exceptions. For example, in special circumstances, the demand for retrial may be made up to three years from the date on which the ground for retrial first arose. (Article 173) The same procedure rules apply to retrial as to trial. (Article 174)

An appeal can be made to the Tokyo High Court. (Article 178) It must be instituted within 30 days from the date the trial decision is transmitted. (Article 178 (3) and (4)) There is no time limit by which the Tokyo High Court must decide.

In sum, an applicant may have to defend his right to a patent to four forums: examiner, trial board, retrial board, and the Tokyo High Court, before his patent rights are enforced by a court. In the meantime, from the time the application is first published, the invention ceases to be secret. If it is commercially valuable, others will want to use it, and so they will have an incentive to challenge registration of the patent for the invention. Opposition before the Patent Office is the first way to attack a patent in Japan; it gives potentially affected parties an opportunity to stop the patent from being registered. Opposition is not the only solution. Anyone, at any time, including immediately after his opposition is rejected, can request a trial for invalidation at the Patent Office. Anyone adversely affected by the issuance of a patent in Japan must challenge its validity at the Patent Office. The presumption of patent validity in an infringement in a Japanese court suit is irrebuttable. However, a party facing an infringement suit can always demand a trial for invalidation (Article 123(1))[15] and the court will usually suspend the suit until the invalidation procedures are completed. Even if a patentee withstands the attack on the validity of its patent, the subsequent infringement trial will continue at intervals of two-three months for several years before a decision is rendered.[16] As one Japanese attorney observed, the trial system may be deliberately inefficient, i.e. too few judges[17] and long-delayed decisions, in order to encourage the parties to settle their dispute amicably. Adding the years taken to resolve the question of infringement to those from the time of application to registration of the patent (five to seven years for an application vigorously opposed), regardless of the intent behind the long path leading to the enforcement of patent rights judicially, the amicable solution of licensing appears much more attractive.

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[14] The issues of infringement and invalidation are decided by judges because the jury system has not been adopted in Japan.

[15] If a party is claiming invalidity through anticipation based on a publication distributed in a foreign country prior to the filing of the patent application or on the basis of obviousness, he must demand an invalidation trial not later than five years from the registration of the patent right. (Article 124)

[16] *Japan* by Masahiko Takeda, in *International Patent Litigation,* Meller, ed., 1986 supp.

[17] In Japan, each judge has an average caseload of 1700 cases. Haley, *The Myth of the Reluctant Litigant* Journal of Japanese Studies.

By laying open the application and examining only upon request, Japan's patent system puts the burden on any would-be infringer to file opposition to the patent application with the Patent Office. The system is built of counterweights. Competitors and others likely to make use of the invention have an incentive to oppose the patent unless they receive a license, and applicants have an incentive to license them to avoid their being opposed. The process of filing and responding to opposition increases the cost of prosecuting the patent application and the likelihood that the patent will not be registered, or delays the date on which the patent is registered. Thus, applicants can avoid costly opposition by licensing those who oppose the patent application.

Publication also allows the research and scientific community to incorporate this advancement relatively promptly into the body of knowledge and accelerate technological development. In Japan, the applicant must share his invention with the public almost immediately. The opportunity to use the invention for research provides an early possibility of improving the invention and advancing the community's body of knowledge. If someone realizes the opportunity and invents an improvement, his reward is not only a patent for his improvement, but also a license for the basic patent.

The Japanese require compulsory non-exclusive licensing of patents in several other situations as well. In addition to the case of a patent for an "improvement" to the main patent, when the patentee has not used the invention continuously for three years, or when having others use the patented invention is particularly necessary for the public interest, the person who intends to use the invention may request the patentee, or the exclusive licensee, to consider granting a non-exclusive license. (Articles 83, 92, 93) If the parties cannot agree on a royalty, they must take the matter to arbitration. Under these circumstances also, the patentee does not have the exclusive right to exploit the patented invention commercially.

Compulsory licensing provisions promote cross-licensing. An applicant for a patent for an invention knows that his competitors will oppose the issue of a patent, increasing his costs of prosecution and delaying the date of issue; all the while the competitors will use the basic invention and work on an improvement which, if successful, will give them the right to license the original invention. However, by voluntarily granting a license to his major competitors promptly, the applicant can avoid the expense and delay of opposition and challenges to his patent rights, and because no compulsory licensing is yet realized, may receive a higher royalty than if he had waited.

The activities of MITI are another reason for widespead licensing in Japan, where many technological breakthroughs are made at the laboratories of the Agency of Industrial Science and Advanced Technology, a division of MITI, or in joint projects with private firms. In either case, MITI owns the patents and licenses all Japanese companies requesting a license. These licenses for MITI technology were not available to foreigners until a few years ago when, for the first time, a United States company, IBM, was granted a blanket license to MITI patents.

There is also another form of compulsory licensing through administrative guidance, without the law being involved. As a condition for approving a direct investment by a foreign enterprise, MITI has in the past required foreigners to license their technology to Japanese competitors.[18] For example, in 1967 Texas Instruments was finally allowed to enter the Japanese market to make semiconductors. At the same time Texas Instruments' pioneer Kirby patent for the semiconductor process was accepted for registration only on the conditions that Sony be taken as a joint venture partner and that the whole Texas Instruments semiconductor patent portfolio be licensed to the nascent Japanese industry.[19]

As explained, the path to obtaining a patent can be long and on average requires five to seven years after the application is filed. During this period, while his invention is made public, the applicant cannot stop anyone from using it commercially. Anyone who is commercially exploiting the invention may be incurring substantial contingent liability, but even after the patent is issued, its owner will be faced with long and costly court proceedings before he can recover damages. The combination of a culture that avoids confrontations and litigation with a patent system that depends on the opposition of interested persons to put forward grounds for a patent not being issued, and that allows the invention to be be used without any immediate recourse, strongly favors a negotiated resolution. Thus, the inventor grants a license to those who want to use the invention, if they appear to be prepared to file opposition and intend to exploit the invention commercially. Moreover, when the potential opposers are granted a license, and do not oppose the application, patent applications that are weak and possibly worthless pass quickly through the Patent Office and are issued. Correlatively, patent applications made by foreigners who do not grant licenses to local opposers find the issuing of the patent long, arduous, and costly.

The Japanese patent system encourages the patent applicant to reach an understanding with others about the use of the invention. Public disclosure of applications, multiple opportunities to oppose them, and compulsory non-exclusive licensing under certain circumstances, all contribute to the pervasive licensing of patents in the Japanese economy.

Japan has a different view of intellectual property from the United States and

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[18] Martin, Edward H., *Licensing of Patents, Trademarks and Know-How*, in *Current Legal Aspects of Doing Business in the Far East*, Richard C. Allison, editor, ABA, 1972.

[19] In the recently concluded litigation between Texas Instruments and the Japanese semiconductor industry concerning patent infringement, Mitusbishi in defense claimed that Texas Instruments was required in about 1967 by MITI to grant licenses for all its semi-conductor technology to the Japanese companies as a condition for allowing Texas Instruments to build a semiconductor plant in Japan and otherwise do business there. See also, *Non-Tariff Trade Barriers to High Technology Trade*, Cohen, Ferguson and Oppenheimer, eds., Boulder and London, 1985, p.17.

Europe. In Japan, a patent principally gives the right to an inventor to receive payment for use of his invention. The view is prevalent in Japan that the advancement of knowledge contributed by an invention belongs principally to the community; the latter, to encourage invention, provides a reward for the inventor. Keeping an invention to oneself is not the Japanese way. If in fact the inventor does not try to patent his invention in Japan, but tries to keep it secret, his secret is not protected by Japanese law as it would be in the United States and Europe.

This fundamental difference is one reason U.S. and European businesses have had trouble protecting their intellectual property in Japan. The United States recognizes that an invention is the property of its inventor and, as consideration for his making the invention public, the state protects his monopoly rights for a certain period. Similarly, if the inventor decides not to make his invention public at the risk of someone else independently discovering the same invention, the United States and European countries recognize the right to make that choice concerning his property and, unlike Japan,[20] will provide real legal protection for his trade secrets. The right to maintain an invention secret is not questioned. The principal focus in the United States is on the individual's right to do what he wants with his property. His inventions belong to him. They become part of the public's knowledge by his choice. In Japan there is a different compact between the inventor and the state from that in the United States. This different relationship is most strikingly exemplified in the distinct views of patent licensing. In Japan licensing is encouraged and in some instances compulsory. In the United States, licensing of patents has been viewed with suspicion and often outlawed. It is only recently, in response to the Japanese domination of our home markets, that the United States government has stopped discouraging licensing of intellectual property.[21]

In short, there are three reasons why Japanese citizens receive a much higher percentage of the patents issued in Japan than in other countries. First, the Japanese are more aggressive in seeking patents. In Japan, patent applications have been known to be filed in anticipation of putting the invention into operation and written as if it were already in use. There is a race to the patent office in Japan and so the Japanese "think patent" throughout the research process. In recent years, the legal and political environments in the other developed countries have become more favorable toward patents and companies have begun to consider patenting very early in the research phase. As this trend continues, they will be filing more patent applications and receiving more patents in Japan.

Patent applications for commercially valuable inventions meet with strong opposition. Japanese companies are better able to handle the opposition process, and their patent departments are ready to respond to opposition in the short time allowed, without the geographical and language barriers which face foreigners, and the concomitant need for time-consuming translations and consultations. Knowing the particular difficulties that opposition presents to foreign applicants, Japanese companies vigorously oppose their applications, requiring many foreigners to abandon them, some to grant licenses to their Japanese competitors, and others to eschew filing completely. For example, a foreigner filing an application covering a basic invention, or a key area of technology, may be confronted with as many as 100 oppositions.[22] Every one of the oppositions must be fully answered in a short period of time.

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[20] In Japan, trade secret law is essentially unfair competition and business tort law. See *Japanese Unfair Competition Prevention Law*, translated in Pinner's *World Unfair Competition Law* (H. David ed. 1978).

[21] See e.g. Remarks of Charles Rule, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, *The Antitrust Implications of International Licensing: After the Nine No-Nos*, BNA's Patent, Trademark & Copyright Journal (11 June, 1986).

The burden imposed by this opposition can be overwhelming and, in the face of it, foreigners often abandon their applications, and others do not file at all. Without a presence in Japan it is practically impossible to respond to such a volume of opposition, but many foreign corporations of significant size have no presence there. For example, of the 200 largest U.S. corporations, only a little more than half have Japanese subsidiaries.[23] More foreign companies need to consider collaborating with each other in doing business in Japan, including joining together to file and prosecute patent applications.

The costly opposition process is not the only impediment especially faced by foreigners in Japan. Once an invention is made public, no-one can be stopped from using it until the patent issues, which can take up to seven years, or during litigation, which moves at a snail's pace. During that period the party using the invention will be working to improve it and, if he does invent an improvement and patents it, this entitles him to a license for the original patent. Thus, the ability in Japan to stop someone from using your patent is limited. As a result, the alternative course of licensing becomes more attractive.

The pressure in Japan is on the licensing of patent "applications". The Japanese regularly share inventions and cross-license their patents. Cross-licensing would clearly discourage opposition at the Patent Office. For foreign companies, though, cross-licensing Japanese competitors in the Japanese market often means ceding it to them. Unless a foreign company has a decided advantage of some kind, it will not be able to compete successfully in Japan against Japanese companies. So, a unique feature or product derived from the patent right of exclusivity may be the only means for a foreign company to compete successfully. However, if the price of obtaining a patent is giving away the right to exlusivity, the reward may no longer be worth the price.

While the environment in which foreigners apply for patent protection in Japan is not favorable, the institutional barriers and conduct of the Japanese industry can be overcome. Patent protection is available in Japan, but it is not cheap, and it cannot be obtained easily.

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[22] See e.g. Testimony of Jonathan W. Hinton, Vice President and General Manager, SOHIO Engineering Materials Company, Before the Subcommittee on Economic Goals and Intergovernment Policy of the Joint Economic Committee on the Case of Japan: Barriers of U.S. Exports, 22 August, 1985.

[23] *Trading With Japan*, Keizai Koho Center, 1985, p.24.

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